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PRIVATE SECTOR CONNECTION TO DEVELOPMENT

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL
DEVELOPMENT INSTITUTIONS AND FINANCE

OF THE

COMMITTEE ON
BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

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PRIVATE SECTOR CONNECTION TO DEVELOPMENT

TUESDAY, JULY 16, 1985

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INTERNATIONAL
DEVELOPMENT INSTITUTIONS AND FINANCE,
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
Washington, DC.

The subcommittee met, pursuant to call, at 9:38 a.m., in room 2222, Rayburn House Office Building, Hon. Stan Lundine (chairman of the subcommittee), presiding.

Present: Chairman Lundine; Representatives Levin and Bereuter.

Chairman LUNDINE. The Subcommittee on International Development Institutions and Finance of the Committee on Banking, Finance and Urban Affairs will please come to order.

I would ask unanimous consent—seeing no others I don't think I would get much objection—that both opening statements of mine and ranking Member, Mr. Bereuter, who will be joining us shortly, be printed in the record in their entirety.

[The opening statements of Chairman Lundine and Mr. Bereuter follow:]

July 16, 1985

OPENING STATEMENT OF CONGRESSMAN STAN LUNDINE

Chairman of Subcommittee on International Development Institutions and Finance

Hearing on the Private Sector Connection to Development

Today, the Subcommittee on International Development Institutions and Finance continues its series of hearings on the role of the multilateral development banks in the international economy.

This morning's hearing will focus on the role of the private sector in the developing countries. Greater emphasis on the private sector has been a trademark of the Reagan Administration in its policy initiatives within the multilateral development banks. [The term private sector is a term of broad scope and means different things to different people. Some believe that all enterprises should be privately owned and operated to ensure efficiencies of cost and production which only free market pressures can bring about. Others do not believe this is a universal economic law applicable in all cases in every country. With regard to economic development in the poorest countries today, there is an important debate about what role the government should play in fostering private sector growth.]

There is little question that the private sector plays a vital role in the economies of the developing countries. The development of these economies depends in no small measure on investment and production by private entrepreneurs. Future growth will certainly depend in great part on the presence of a vigorous private sector.

[However, to acknowledge the importance of the private sector to long term economic development does not necessarily mean that governments cannot play a catalytic role in economic development. Further, many countries, including the United States, have undertaken initiatives in the public sector which the private sector has been unwilling or unable to provide. I think of, for instance, the National Aeronautics and Space Administration which has unquestionably spurred economic development over the last thirty years in this country. So while it may be desirable to enhance the climate for private sector development in many of the developing countries the reality is that most countries including our own have mixed economies. The multilateral banks therefore have to work within the constraints of the economic system in the recipient country. The MDBs should however, continue to carefully analyze prospective development projects to ensure that with the limited resources at their disposal they are not paying for something that would otherwise be privately financed.]

The Subcommittee will hear from four distinguished witnesses.

Frank Carlucci, President of Sears World Trade, will lead off with a general discussion of his views on the importance of the private sector to development. Mr. Carlucci has led a distinguished career in both the public and private sector. In 1983, he was appointed chairman of the blue ribbon Commission on Economic and Security Assistance. He also served in both Democratic and Republican administrations in many capacities including Deputy Secretary of Defense 1981-1983 and U.S. Ambassador to Portugal 1975-1977.

Carl Liedholm, School of Agricultural Economics at Michigan State University, will comment on the private sector in Africa and particularly the importance of a healthy small scale, indigenous private economy which may not always be wholly compatible with larger projects that often receive the most money and attention. Professor Liedholm is currently researching a project entitled "Small Enterprise Approaches to Employment" under a grant provided by the U.S. A.I.D.

Margaret Hayes, Executive Director of the Council of the Americas, will talk about the role of the private sector in Latin America and the potential for future growth in that region. Ms. Hayes was formerly on the staff of the Senate Foreign Relations Committee.

Laerte Setubal Fioho, President of the Association of Brazilian Exporters. Mr. Setubal will provide the Subcommittee with a valuable perspective of one who works in the private sector of a developing country.

INTRODUCTORY STATEMENT BY HON. DOUG BEREUTER

Mr. Chairman, I also would like to welcome today's distinguished witnesses - I think we will cover the issue from all sides and from all geographic areas. I am greatly looking forward to discussing many of the topics our knowledgeable panel will bring to light.

This issue is a crucial one today. This U.S. Administration has rallied the forces of private initiative and entrepreneurship since it took office in 1981. At first, it was a lonely cry. Now, all over Africa, for example, the intelligentia is talking of the need to "privatize" and to give the responsibilities of production back to the "individual". Indeed, Africans and foreigners admit that 20 years of economic development through centralized government decision making has not substantially improved the lot of the people of the continent. For those whose memory of Biafra is dimming, Ethiopia is a quick and tragic reminder.

In many large and small developing countries, government policy has created unfavorable conditions for the growth of the private sector. I am pleased that the U.S. Agency for International Development and the multilateral development banks are beginning to work with developing nations to improve the climate for the growth of business. The MDB's, after all, are the greatest international repository of economic expertise.

I am fully aware that this issue of privatization is not solely an economic one in the Third World. Rather, many see the advance of private sector as a second phase of colonialism and dependence on the

industrialized north. I agree that we in the U.S. should be more aware of the political connotations of the private sector in part of the Third World. Private enterprise isn't the cure-it-all of the woes of the developing world. Indeed, I think there is room for a legitimate discussion of the role of the state in a new and growing economy. Some state enterprises are even quite successful. But, a balance must be sought to bring down policies which obstruct private enterprise and growth, particularly in rural areas.

Lastly, Mr. Chairman, developing countries needing capital and employment opportunities should try to bring down barriers which block foreign investment. Many of these nations' previous concerns with large multinationals were understandable, but 1985 is not 1950. To retain old laws which obstruct a ready and quick source of capital is very unfortunate.

I am greatly looking forward to hear the testimony of our knowledgeable witnesses.

Thank you.

Chairman LUNDINE. Today the Subcommittee on International Development Institutions and Finance continues its series of hearings on the role of the multilateral development banks in the international economy.

This morning's hearings will focus on the role of the private sector in the developing countries. Greater emphasis on the private sector has been a trademark of the Reagan administration in its policy initiatives within and toward the multilateral development banks. There is little question that the private sector plays a vital role in the economies of the developing countries.

The development of these economies depends in no small measure on investment and production by private entrepreneurs. Future growth will certainly depend in great part on the presence of a vigorous private sector.

The subcommittee will hear from four distinguished witnesses today, Mr. Setubal, president of the Brazilian Exporters Association will provide the subcommittee with a valuable perspective of one who works in the private sector in a developing country.

Mr. Liedholm from the School of Agricultural Economics at Michigan State University will comment on the private sector in Africa, particularly the importance of a healthy, small-scale indigenous private economy which may not always be wholly compatible with larger projects that often receive the most money and attention.

Professor Liedholm is currently researching a project entitled "Small Enterprise Approaches to Employment" under a grant by the U.S. Agency for International Development.

Margaret Hayes, executive director of the Council of the Americas, will talk about the role of the private sector in Latin America and the potential for future growth in that region. Ms. Hayes was formerly on the staff of the Senate Foreign Relations Committee, for which we will excuse her.

Frank Carlucci, president of Sears World Trade, will lead off with a general discussion of his views on the importance of the private sector to development.

Mr. Carlucci has led a distinguished career in both the public and private sector. In 1983 he was appointed Chairman of the Commission on Economic and Security Assistance. He also served in both Democratic and Republican administrations in many capacities, including Deputy Secretary of Defense, from 1981 to 1983, and U.S. Ambassador to Portugal from 1975 to 1977.

Chairman LUNDINE. Ladies and gentlemen, your entire statements will be made a part of the record. We would appreciate your summarizing them if that is possible, and we really appreciate your being with us and expect the subcommittee to benefit greatly from your testimony.

As I said in my formal opening, this is part of a series of hearings where we are really trying to probe indepth into some of the issues and innovations that may be necessary in this area, and the administration has been good enough to say that they would be delighted to testify last rather than first. Usually they testify first in the process of hearings like this, but it was my idea that maybe we could uncover some of the issues and some innovations that may be needed in this challenging time and then talk to the administra-

tion after the Labor Day period about some of them so that we can have a good dialog and hopefully have constructive policy development, both from the legislative and executive branches.

I think we will begin with Mr. Carlucci.

STATEMENT OF FRANK CARLUCCI, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, SEARS WORLD TRADE, INC.

Mr. CARLUCCI. Thank you, Mr. Chairman. It is a pleasure to appear before the subcommittee.

Let me state at the outset I do not consider myself an expert on the subject of your hearing today, but as you pointed out I did have the privilege of chairing for Secretary Shultz a Commission on Economic and Security Assistance, and I would ask the conclusions and recommendations of this Commission be placed in the record if you so agree.

Chairman LUNDINE. Without objection, they will be in their entirety made a part of the record.

[The conclusions and recommendations of "A Report to the Secretary of State of the Commission on Security and Economic Assistance referred to by Mr. Carlucci is attached to his prepared statement.]

Mr. CARLUCCI. Let me mention the two recommendations of the Commission that are most germane to the session today. One, increasing the World Bank role in supporting policy reforms. The Commission concluded that resource transfers are only useful in achieving U.S. objectives if they are accompanied by the effective use of these resources.

This means policy change in the receiving countries. The Commission concluded that given its prominence and experience the World Bank should take the lead in coordinating the recipients of assistance, coordinating the donors of assistance more effectively.

The second recommendation was the performance of the private sector. The Commission emphasized that a vigorous private sector is essential to the development process in all LDCs ranging from middle income to the least developed countries, and encouraged the use of multilateral and bilateral programs to promote policies that encourage indigenous private sector initiatives.

Specifically the Commission recommended and I quote, "The USG should continue to encourage the World Bank and its IFC affiliate to emphasize policy reform and focus direct activity on private sector development."

Our own programs should be similarly directed.

In addition to these two recommendations relating to multilateral coordination in the private sector, the Commission made a number of other reenforcing recommendations which I will not elaborate on here. But taken together, these recommendations present a strong argument to strengthen our foreign aid program. Not all relate directly to multilateral development or the private sector, but all are consistent with lending through the MDBs and with support of the private sector.

Before concluding let me add a couple of personal observations.

It is my judgment that the past few years have witnessed a rather dramatic change in thinking about foreign assistance. Prior

to recent times, foreign assistance was focused almost exclusively on how to make the public sector more effective. In contrast currently, there is widespread recognition that the private sector generates almost three-quarters of the gross domestic product of the developing countries.

Moreover, the prospects for significantly increasing output seem to be almost entirely within the private sector. Indeed, with the strong push from the World Bank and the IMF there is now major pressure to privatize many of the parastatal organizations in order to cut budget outlays and enhance growth prospects.

Some of the credit for this can go to the administration's advocacy of the private sector. Some of it can go to the Commission chaired by Dwayne Andreas but more importantly I think the example of certain countries, particularly in the Pacific rim, has served to inspire a renewed examination of the benefits of supporting the private sector.

The World Bank has played a very supportive role and I see the World Bank as increasingly interested in stimulating the private sector, as is our own aid program. The World Bank is doing this in several ways. For several years, it has been improving the environment for the private sector by building the necessary infrastructure and supporting proper policies. It has done this by requiring sensible economic policies as preconditions to its sector loans. It's now involved in structural adjustment assistance lending, which is more directly related to policy change in the receiving countries.

Second, the World Bank and its private sector-oriented affiliate, the IFC, has directly promoted private sector growth. The IFC that does this by stimulating indigenous capital markets and encouraging the growth of export industries.

The IFC's goal is to play a catalytic role rather than supplant the private sector.

Based on my recent experience in the business world, I have seen the very important role that the private sector can play in the LDC's. I would enter, though, a cautionary note when we talk about stimulating the private sector through the MDB's.

Even when we have tried to stimulate the private sector in our own country through Government programs we have suffered frustrations and setbacks, so I think we have to exhibit a good deal of patience as we take this approach in the even more complicated international area.

This is not a criticism. It simply suggests that it will require considerably more effort than is being made now, even with the initiatives that are currently under way.

In the long run it may be the policy changes that the World Bank is promoting that will have the greatest stimulative effect on the private sector.

A second cautionary note is that we not get caught up in some kind of a sterile ideological debate on the private sector versus socialism. I happen personally to believe that the private sector can produce far more benefits than Government activity in the business area, but this issue should not be addressed through personal national predilections, it should be addressed on the evidence at hand.

In conclusion, let me mention a similar but slightly broader concern. The Commission on Security and Economic Assistance made a strong argument for the several ways in which foreign aid serves U.S. national interests, our political, national security, economic, and humanitarian goals.

All of these make a strong case for enhanced effectiveness and indeed increased aid levels. But the respective constituencies for aid are divided in their views. Most select only one goal and disparage the others. This leads to frustrating sterile and sometimes ideologically charged debates on such issues as security versus developmental and bilateral versus multilateral assistance.

The fact is that all of these are useful tools. We need to use each in the measure required by the situation in the country or region in which we are dealing.

Programs should be based on country needs and not on some a prior view in Washington of what the appropriate percentages are that should be devoted to the different kinds of aid.

This concept is at the heart of the Commission's recommendations. If we adopt this, it will make it easier to remove obstacles to and create additional stimuli for greater private sector activity.

The multilateral institutions can and will play a crucial role in unleashing human creativity and productivity that accompanies such activity.

That completes a summary of my statement, Mr. Chairman.

[The prepared statement of Mr. Carlucci with attached conclusions and recommendations of the "Report to the Secretary of State of the Commission on Security and Economic Assistance" follow:]

STATEMENT OF FRANK C. CARLUCCI
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
SEARS WORLD TRADE, INC.
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL DEVELOPMENT
INSTITUTIONS AND FINANCE
U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON
BANKING, FINANCE AND URBAN AFFAIRS
JULY 16, 1985

MR. CHAIRMAN, DISTINQUISHED MEMBERS OF THE SUBCOMMITTEE. I AM PLEASED TO APPEAR BEFORE YOU THIS MORNING TO DISCUSS OUR MUTUAL ASSISTANCE PROGRAMS AND THE PRIVATE SECTOR CONNECTION TO DEVELOPMENT.

AT THE OUTSET, LET ME STATE THAT I DO NOT CONSIDER MYSELF AN EXPERT ON THE INTRACACIES OF THE FOREIGN ASSISTANCE PROGRAM NOR ON THE ROLE OF THE PRIVATE SECTOR IN THE DEVELOPMENT PROCESS. I DID, HOWEVER, HAVE THE HONOR [illegible] THE CHALLENGE OF CHAIRING A COMMISSION APPOINTED BY SECRETARY SHULTZ IN 1983 TO REVIEW THE GOALS AND ACTIVITIES OF THE UNITED STATES FOREIGN ASSISTANCE PROGRAM. THEREFORE I WOULD LIKE TO TAKE A FEW MINUTES TO DISCUSS SOME OF THE CONCLUSIONS OF THE COMMISSION AND TO ADD SEVERAL PERSONAL OBSERVATIONS.

WITH YOUR PERMISSION, MR. CHAIRMAN, I HOPE THE CONCLUSIONS AND RECOMMENDATIONS OF THE COMMISSION CAN BE SUBMITTED FOR THE RECORD AS PART OF MY FORMAL STATEMENT BEFORE THE SUBCOMMITTEE.

THE COMMISSION MADE SEVENTEEN MAJOR RECOMMENDATIONS. THE COMMISSION WAS COMPRISED OF A VARIETY OF OUTSIDE EXPERTS REPRESENTING A NUMBER OF CONSTITUENCIES AND POINTS OF VIEW. IT INCLUDED CONGRESSMEN AND SENATORS, INCLUDING MR. BEREUTER OF THIS SUBCOMMITTEE. WHILE NOT EVERY MEMBER ENDORSED EVERY SENTENCE IN THE REPORT, I THINK THERE WAS REMARKABLE CONSENSUS ON ITS BROAD CONCLUSIONS.

I WOULD LIKE TO TOUCH BRIEFLY ON THE TWO CONCLUSIONS WHICH ARE PARTICULARLY RELEVANT TO THE CURRENT DELIBERATIONS OF THE SUBCOMMITTEE.

(1) INCREASING THE WORLD BANK ROLE IN SUPPORTING POLICY REFORMS.

THE COMMISSION CONCLUDED THAT RESOURCE TRANSFERS CAN ONLY BE EFFECTIVE IN ADVANCING U.S. OBJECTIVES IF THE UNDERLYING POLICIES OF THE RECIPIENT COUNTRIES ENCOURAGE THE EFFECTIVE USE OF THESE RESOURCES. AS A RESULT, U.S. COOPERATION SHOULD BE TAILORED TO SUPPORT THE EVOLUTION OF POLICIES THAT WILL ULTIMATELY RESULT IN OPEN, SELF-SUSTAINING ECONOMIES AND DEMOCRATIC SOCIETIES. FURTHERMORE, TO BE FULLY EFFECTIVE, THE UNITED STATES HAS TO COORDINATE ITS EFFORTS WITH OTHER DONORS. THUS, THE COMMISSION CONCLUDED THAT "GIVEN ITS PROMINENCE AND EXPERIENCE, THE WORLD BANK SHOULD TAKE THE LEAD IN COORDINATING THE PARTICIPANTS MORE EFFECTIVELY."

(2) THE IMPORTANCE OF PROMOTING THE PRIVATE SECTOR.

THE COMMISSION ALSO EMPHASIZED THAT A VIGOROUS PRIVATE SECTOR IS ESSENTIAL TO THE DEVELOPMENT PROCESS IN ALL DEVELOPING COUNTRIES -- RANGING FROM THE MIDDLE INCOME TO THE LEAST DEVELOPED COUNTRIES. THE COMMISSION ENDORSED THE USE OF OUR BILATERAL AND MULTILATERAL COOPERATION PROGRAMS TO PROMOTE POLICIES THAT ENCOURAGE INDIGENOUS PRIVATE SECTOR INITIATIVES. WITHOUT THOSE INITIATIVES, BILATERAL AND MULTILATERAL ASSISTANCE CANNOT BE FULLY EFFECTIVE.

SPECIFICALLY IN THIS REGARD, THE COMMISSION RECOMMENDED THAT THE UNITED STATES "SHOULD CONTINUE TO ENCOURAGE THE WORLD BANK AND ITS IFC AFFILIATE TO EMPHASIZE POLICY REFORM AND FOCUS THEIR DIRECT ACTIVITIES ON PRIVATE SECTOR DEVELOPMENT. OUR OWN PROGRAMS SHOULD BE SIMILARLY DIRECTED." THE COMMISSION ALSO RECOGNIZED THAT THE U.S. PRIVATE SECTOR -- BUSINESS, BANKING, VOLUNTARY ORGANIZATIONS, AND NON-PROFIT INSTITUTIONS -- CONTRIBUTES TO DEVELOPMENT AND SHOULD BE UTILIZED AND SUPPORTED WHEREVER APPROPRIATE.

IN ADDITION TO THESE TWO RECOMMENDATIONS RELATING TO MULTILATERAL COOPERATION AND THE PRIVATE SECTOR, THE COMMISSION MADE A NUMBER OF OTHER REINFORCING RECOMMENDATIONS, INCLUDING THE NEED TO: ESTABLISH BIPARTISAN LEADERSHIP SUPPORT, PROMOTE A CITIZEN'S NETWORK, CONTINUE SUPPORT FOR DEVELOPMENT EDUCATION, INCREASE

ASSISTANCE LEVELS, ADOPT A COUNTRY APPROACH TO PROGRAM DEVELOPMENT, ENSURE INTEGRATED PROGRAMS FOR THE CARIBBEAN REGION AND SUB-SHARAN AFRICA, ENCOURAGE HUMAN RESOURCE DEVELOPMENT AND INSTITUTION BUILDING, EMPHASIZE SCIENCE AND TECHNOLOGY, IMPROVE EVALUATION, MAINTAIN FLEXIBILITY, SUPPORT PL-480 DEVELOPMENT OBJECTIVES, INCREASE CONCESSIONALITY OF MILITARY ASSISTANCE, ESTABLISH A MUTUAL DEVELOPMENT AND SECURITY ADMINISTRATION, AND CREATE A NEW EXECUTIVE-LEGISLATIVE CONSULTATIVE GROUP.

TAKEN TOGETHER, THESE RECOMMENDATIONS PRESENT AN INTERNALLY REINFORCING SET OF PROPOSALS TO STRENGTHEN OUR FOREIGN AID PROGRAM. NOT ALL DIRECTLY RELATE TO MULTILATERAL DEVELOPMENT AND OR THE PRIVATE SECTOR, BUT ALL ARE CONSISTENT WITH A GREATER ROLE FOR THE DEVELOPMENT BANKS IN PROMOTING PRIVATE SECTOR GROWTH. I WOULD BE PLEASED TO DISCUSS ANY OF THE COMMISSION'S RECOMMENDATIONS IN MORE DETAIL.

BEFORE CONCLUDING, HOWEVER, I WOULD LIKE TO ADD A FEW PERSONAL THOUGHTS ON THE ROLE OF FOREIGN AID AND PRIVATE SECTOR IN THE DEVELOPMENT PROCESS.

FROM MY PERSPECTIVE AS AN INTERESTED OUTSIDE OBSERVER, IT APPEARS THAT A DRAMATIC REORIENTATION IN THINKING ABOUT DEVELOPMENT IS UNDERWAY. OVER THE PAST SEVERAL DECADES THE FOCUS OF DEVELOPMENT

EXPERTS HAS BEEN ALMOST EXCLUSIVELY ON HOW TO MAKE THE PUBLIC SECTOR MORE EFFECTIVE. IN CONTRAST, IN THE LAST FEW YEARS, THERE HAS BEEN WIDESPREAD RECOGNITION THAT THE PRIVATE SECTOR GENERATES ALMOST THREE QUARTERS OF THE GROSS DOMESTIC PRODUCT OF THE DEVELOPING COUNTRIES. MOREOVER, THE PROSPECTS FOR SIGNIFICANTLY INCREASING OUTPUT SEEM TO BE ALMOST ENTIRELY WITHIN THE PRIVATE SECTOR. INDEED, WITH A STRONG PUSH FROM THE WORLD BANK AND THE IMF, THERE IS NOW MAJOR PRESSURE TO "PRIVATIZE" INEFFICIENT PARASTATAL ORGANIZATIONS IN ORDER TO CUT GOVERNMENT BUDGETARY LOSSES AND ENHANCE GROWTH PROSPECTS.

SOME OF THE CREDIT FOR THIS AWARENESS OF THE CRUCIAL ROLE OF THE PRIVATE SECTOR CAN BE GIVEN TO THE REAGAN ADMINISTRATION AND ITS EMPHASIS ON PRIVATE SECTOR INITIATIVE IN THE UNITED STATES. THE ADMINISTRATION HAS ALSO CHAMPIONED THE ROLE OF THE PRIVATE SECTOR IN STIMULATING WORLDWIDE GROWTH; ONE OF THE MECHANISMS FOR PROMOTING THIS VIEW WAS THE PRESIDENT'S TASK FORCE ON INTERNATIONAL PRIVATE ENTERPRISE, CHAIRED BY DWAYNE ANDREAS. MORE IMPORTANTLY, THOUGH, I BELIEVE THAT THE RECORD OF THE EXPORT-ORIENTED, MARKET DRIVEN ECONOMIES, PRIMARILY ON THE PACIFIC RIM, HAS PROVIDED THE MOST PERSUASIVE CASE FOR THE BENEFITS OF GROWTH LED BY THE PRIVATE SECTOR.

THE WORLD BANK HAS PLAYED AN IMPORTANT, BUT LARGELY UNHEARLDED ROLE IN CONVEYING THIS CASE TO INFLUENTIAL DECISION-MAKERS IN THE DEVELOPING WORLD. SEVERAL ANNUAL DEVELOPMENT REPORTS BY THE WORLD

BANK HAVE PRESENTED STATISTICAL EVIDENCE THAT THE MARKET ORIENTED ECONOMIES HAVE PERFORMED MUCH BETTER THAN THOSE WHICH ALLOWED EXCESSIVE GOVERNMENT INTERVENTION. THE FACT THAT THE WORLD BANK IS MAKING THIS CASE CARRIES GREAT WEIGHT WITH SKEPTICAL AUDIENCES IN THE THIRD WORLD. MORE RECENTLY, THE PRESIDENT OF THE WORLD BANK, BILL CLAUSEN, HAS BEEN ARGUING THAT BILATERAL AND MULTILATERAL AID AGENCIES MUST GIVE THE PRIVATE SECTOR GREATER WEIGHT IN THE DIALOGUE ON GROWTH POLICIES.*

FROM THE EVIDENCE I HAVE SEEN, THE MESSAGE IS GETTING THROUGH. THE U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT IS TRYING TO INCREASE THE PRIVATE SECTOR ORIENTATION OF ITS PROGRAMS. OF GREATER INTEREST TO THIS SUBCOMMITTEE THE WORLD BANK IS CONTINUING TO BUILD ITS CAPABILITY TO ASSIST THE PRIVATE SECTOR. IT IS DOING THIS IN SEVERAL WAYS:

- FIRST, AND IN MY VIEW MOST IMPORTANTLY, THE WORLD BANK FOR MANY YEARS HAS DONE A GOOD JOB OF IMPROVING THE ENVIRONMENT FOR THE PRIVATE SECTOR. BY BUILDING NECESSARY INFRASTRUCTURE AND PRESSING FOR MARKET ORIENTED PRICES AND

*SEE FOR EXAMPLE HIS ADDRESS TO THE INSTITUTE OF DIRECTORS, LONDON ENGLAND. A.W. CLAUSEN, "PROMOTING THE PRIVATE SECTOR IN DEVELOPING COUNTRIES," THE WORLD BANK, FEBRUARY 26, 1985.

POLICIES, THE BANK HELPS SET THE STAGE FOR PRIVATE ENTERPRISE TO FLOURISH. IT HAS TRADITIONALLY DONE THIS BY REQUIRING SENSIBLE ECONOMIC POLICIES AS PRECONDITIONS TO ITS SECTOR LOANS. MORE RECENTLY, IT HAS ADDED MACRO-ECONOMIC AND OTHER POLICIES -- SUCH AS PRIVATIZATION -- AS CONDITIONS FOR ITS STRUCTURAL ADJUSTMENT ASSISTANCE LENDING.

- SECOND, THE WORLD BANK, AND PARTICULARLY ITS PRIVATE SECTOR ORIENTED AFFILIATE THE INTERNATIONAL FINANCE CORPORATION (IFC), HAS DIRECTLY PROMOTED PRIVATE SECTOR GROWTH. THE BANK HAS DONE THIS THROUGH PROJECTS DESIGNED, FOR EXAMPLE, TO DEVELOP INDIGENEOUS CAPITAL MARKETS AND TO ENCOURAGE THE GROWTH OF EXPORT INDUSTRIES. THE IFC ALSO PROMOTES THE PRIVATE SECTOR DIRECTLY BY ENCOURAGING THE FLOW OF PRIVATE INVESTMENT INTO THE LESS DEVELOPED COUNTRIES. THE WORK OF THE IFC WILL NOW BE COMPLEMENTED SIGNIFICANTLY IF THE DONOR NATIONS SUPPORT THE CREATION OF THE RECENTLY PROPOSED MULTILATERAL INVESTMENT GUARANTEE AUTHORITY. THIS MULTILATERAL ENTITY WOULD BE A VALUABLE COMPLEMENT TO EXISTING BILATERAL AGENCIES SUCH AS OUR OVERSEAS PRIVATE INVESTMENT CORPORATION (OPIC) IN ENCOURAGING FURTHER PRIVATE INVESTMENT IN THE DEVELOPING COUNTRIES.

BASED ON MY EXPERIENCE AT SEARS WORLD TRADE, I HAVE SEEN FIRST-HAND THE CONTRIBUTION THAT PRIVATE ENTREPRENEURS CAN MAKE TO GROWTH AND EMPLOYMENT EVEN IN THE POOREST COUNTRIES. THEREFORE, THE TYPES OF INITIATIVES UNDERWAY IN THE MULTILATERAL AND BILATERAL PROGRAMS DESERVE OUR STRONGEST SUPPORT.

HOWEVER, THERE ARE ALSO SEVERAL IMPORTANT CAUTIONARY NOTES. ONE OF MY CONCERNS IS THAT WE WILL EXPECT TOO MUCH TOO SOON. EVEN IN THIS COUNTRY, OUR EXPERIENCE WITH GOVERNMENT PROGRAMS DESIGNED TO STIMULATE THE PRIVATE SECTOR HAS NOT BEEN VERY IMPRESSIVE. A QUICK LOOK AT THE DIFFICULTIES WITH SMALL BUSINESS, ECONOMIC ADJUSTMENT, AND REGIONAL DEVELOPMENT PROGRAMS SUGGESTS THAT THERE ARE MANY PROBLEMS IN MAKING THESE PROGRAMS MEET THEIR OBJECTIVES AT REASONABLE COST. IT IS EVEN MORE DIFFICULT TO DESIGN COST-EFFECTIVE FOREIGN AID PROGRAMS TO PROMOTE PRIVATE SECTOR GROWTH IN THE DEVELOPING COUNTRIES.

NOTING THE DIFFICULTIES IN DESIGNING APPROPRIATE PROGRAMS TO ASSIST THE PRIVATE SECTOR DIRECTLY IS NOT A CRITICISM. IT SIMPLY SUGGESTS THAT AID, THE WORLD BANK AND OTHER MAJOR DONORS NEED TO DEVOTE CONSIDERABLY MORE EFFORT TO EXPERIMENTING WITH NEW APPROACHES, BRINGING IN FRESH FACES, AND CRITICALLY EVALUATING WHAT SEEMS TO WORK AND WHAT DOESN'T. SIMILARLY, CONGRESS WILL HAVE TO SHOW PATIENCE IN CONTINUING TO FUND THESE INITIATIVES WHILE KEEPING UP THE PRESSURE TO SEE RESULTS.

IN THE LONG RUN, IT MAY WELL BE THAT THE GREATEST CONTRIBUTION TO PRIVATE SECTOR GROWTH WILL CONTINUE TO COME FROM THE TYPES OF POLICY REFORMS THE BANK IS PUSHING RATHER THAN FROM SPECIFIC PROGRAMS OF ASSISTANCE TO THE PRIVATE SECTOR.

ANOTHER CONCERN IS THAT WE NOT LET THE CURRENT FOCUS ON THE PRIVATE SECTOR DEGENERATE INTO STERILE IDEOLOGICAL DEBATE. THE QUESTION OF PUBLIC VERSUS PRIVATE SECTOR EMPHASIS SHOULD NOT BE POSED IN TERMS OF SOCIALISM VERSUS CAPITALISM. THE QUESTION IS WHAT VEHICLES WORK BEST IN PARTICULAR CIRCUMSTANCES TO LIBERATE THE POOR FROM THE TYRANNY OF POVERTY. I PERSONALLY BELIEVE THAT IN MOST INSTANCES, WITH APPROPRIATE GOVERNMENTAL POLICIES, THE PRIVATE SECTOR OFFERS BY FAR THE BEST PROSPECTS. BUT THE QUESTION SHOULD BE RESOLVED BY THE EVIDENCE, NOT BY PERSONNAL PREDILECTIONS. I BELIEVE THAT THE WORLD BANK AND OTHER MULTILATERAL DEVELOPMENT BANKS CAN PLAY CRUCIAL ROLES IN EXAMINING THE FACTS OBJECTIVELY AND IN ADVOCATING APPROPRIATE POLICIES.

IN CONCLUDING, I WOULD ALSO LIKE TO MENTION A SIMILAR BUT SLIGHTLY BROADER CONCERN. THE COMMISSION ON SECURITY AND ECONOMIC ASSISTANCE MADE A STRONG ARGUMENT FOR THE SEVERAL WAYS IN WHICH FOREIGN AID SERVES U.S. NATIONAL INTERESTS; I.E. OUR POLITICAL, NATIONAL SECURITY, ECONOMIC AND HUMANITARIAN GOALS. ALL OF THESE

ADD UP TO A COMPELLING CASE FOR IMPROVING THE EFFECTIVENESS AND INCREASING THE AMOUNTS OF FOREIGN ASSISTANCE. BUT THE RESPECTIVE CONSTITUENCIES FOR FOREIGN AID ARE DIVIDED IN THEIR VIEWS. MOST SELECT ONLY ONE GOAL AND DISPARAGE THE OTHERS. THIS LEADS TO FRUSTRATING, STERILE AND SOMETIMES IDEOLOGICALLY CHARGED DEBATES ON SUCH ISSUES AS SECURITY VERSUS DEVELOPMENTAL, AND BILATERAL VERSUS MULTILATERIAL ASSISTANCE.

THE FACT IS THAT ALL OF THESE ARE USEFUL TOOLS. WE NEED TO USE EACH IN THE MEASURE REQUIRED BY THE SITUATION IN THE COUNTRY OR REGION WITH WHICH WE ARE DEALING. PROGRAMS SHOULD BE BASED ON COUNTRY NEEDS, NOT SOME A PRIORI VIEW IN WASHINGTON ON APPROPRIATE PERCENTAGES TO BE DEVOTED TO DIFFERENT KINDS OF AID. THIS CONCEPT WAS AT THE HEART OF THE COMMISSION'S RECOMMENDATIONS. SUCH AN APPROACH ALSO MAKES IT EASIER TO REMOVE THE OBSTACLES TO AND CREATE INCENTIVES FOR GREATER PRIVATE SECTOR ACTIVITY. THE MULTILATERAL INSTITUTIONS CAN AND WILL PLAY A CRUCIAL ROLE IN UNLEASHING THE HUMAN CREATIVITY AND PRODUCTIVITY THAT ACCOMPANIES SUCH ACTIVITY.

THANK YOU, MR. CHAIRMAN, FOR INVITING ME TO APPEAR BEFORE THIS SUBCOMMITTEE.

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THE COMMISSION ON SECURITY AND ECONOMIC ASSISTANCE

A REPORT TO THE SECRETARY OF STATE

Our security and economic assistance programs are essential instruments in our foreign policy and are directly linked to the national security and economic well-being of the United States.

Secretary of State George P Shultz
House Foreign Affairs Committee Hearing
February 16, 1983

Mr Secretary

On February 22, 1983, you announced the formation of a commission to review the goals and activities of United States foreign assistance efforts. Drawing upon the broad experience of its bipartisan membership, the Commission on Security and Economic Assistance undertook this critical task.

Over the past several months, the Commission has looked at U.S. economic and security assistance programs to determine if and how they serve the interests of the United States, including a stronger international economy, improved prospects for world peace and heightened emphasis on basic humanitarian and democratic values.

In examining these global relationships, the Commission found many of these programs to be mutually beneficial. For this reason, it is important to note that the terms 'foreign cooperation' and 'mutual assistance' are used interchangeably in this report.

The Commission gratefully acknowledges the substantive and administrative support of the Georgetown University Center for Strategic and International Studies and the assistance of individuals – representing several government departments and agencies – as well as the many legislative staff members, scholars and researchers who contributed to the preparation of this document.

Respectfully submitted,

MEMBERS OF
THE COMMISSION ON SECURITY
AND ECONOMIC ASSISTANCE

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President, Sears World Trade, Inc.

The Honorable Joseph Lane Kirkland
Co-Chairman
President, AFL-CIO

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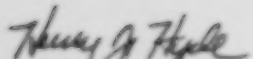
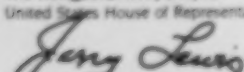
The Honorable Dante B. Fascell
United States House of Representatives

Edwin J. Feulner, Jr.
President, Heritage Foundation



The Honorable Henry J. Hyde
United States House of Representatives



The Honorable Jerry Lewis
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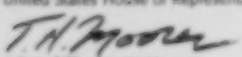
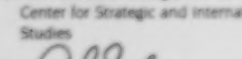


Admiral Thomas H. Moorer
Senior Associate, Georgetown University Center for Strategic and International Studies



The Honorable Paul S. Sarbanes
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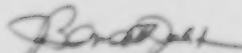

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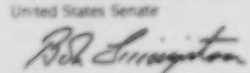

The Honorable Robert L. Livingston
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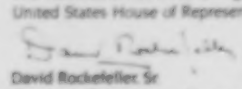
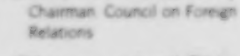
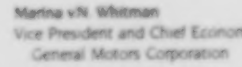


David Rockefeller, Sr.
Chairman, The Americas Society
Chairman, Council on Foreign Relations



Marina v.N. Whitman
Vice President and Chief Economist, General Motors Corporation



The Honorable Douglas K. Bereuter
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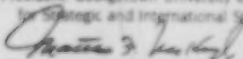
Amos A. Jordan
President, Georgetown University Center for Strategic and International Studies



The Honorable Matthew F. McHugh
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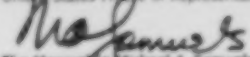

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Vice President, International, Chamber of Commerce of the United States

The Honorable William S. Broomfield
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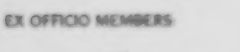

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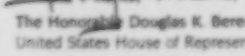

The Honorable E. "Kika" de la Garza
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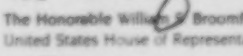

The Honorable Pete V. Domenici
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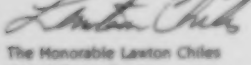

The Honorable Walter D. Huddleston
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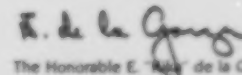

The Honorable Daniel K. Inouye
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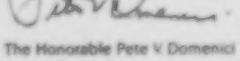
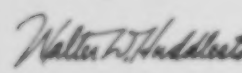
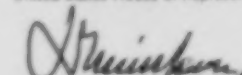


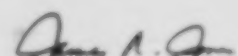
The Honorable James A. Jones
United States House of Representatives



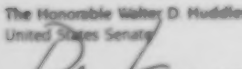
The Honorable Robert W. Kasten, Jr.
United States Senate



The Honorable Jack F. Kemp
United States House of Representatives



The Honorable Delbert L. Latta
United States House of Representatives



The Honorable Jerry M. Patterson
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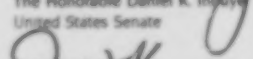
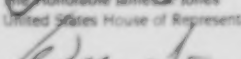


The Honorable Charles H. Percy
United States Senate



The Honorable Clement J. Zablocki
United States House of Representatives

CONCLUSIONS AND RECOMMENDATIONS

Establish Bipartisan Leadership Support

Foreign cooperation is an indispensable tool of U.S. foreign policy. The President is clearly the most effective advocate for the program. A sustained, active and highly visible role on the part of the President as well as the bipartisan leadership of the House and the Senate will help to ensure the kind of support for the foreign cooperation program that we believe it deserves. The Commission urges that the Congressional leadership join the President in a statement endorsing our conclusion that the foreign security and economic cooperation programs of the United States are mutually supportive and interrelated and together constitute an essential and integral part of the foreign policy of the United States. In order to gain broader Congressional and public support for the program, such active leadership is essential.

Promote a Citizens' Network

Many Americans have a direct interest in programs of foreign assistance. The agricultural sector and the banking community, for example, benefit substantially. Other U.S. beneficiaries include agribusiness, whose overseas markets expand as developing countries prosper and modernize; the labor force, whose job opportunities increase; corporations whose profits from exports or foreign investments depend on conditions in Third World countries; the shipping and transportion industry; private and voluntary agencies; and land- and sea-grant colleges and universities, which participate in the design and implementation of foreign assistance programs.

Yet the general public does not perceive that U.S. foreign assistance efforts serve the economic and security interests of the United States. The Commission believes that, in many instances, these views result from a lack of accurate and timely information. Furthermore, unlike many other U.S. programs, the favorable impacts of foreign assistance programs are often diffuse and indirect. They are also longer-term in character. Special attention and continuous access to current information is vital to appreciating the benefits of these programs.

To assure that the public is better informed, the Commission recommends the creation of a privately funded citizens' network. We believe that an informed public will support the assistance program and stimulate greater support in Congress. Although the major force behind such a network must be the private sector, the U.S. Government could assist by providing speakers and appropriate informational materials.

Many groups – such as foreign policy associations, veterans' organizations and returned Peace Corps volunteers – have an active network and an ongoing interest in security and economic assistance. Such well- organized, knowledgeable but sometimes underutilized groups could provide the nucleus around which a broader-based information system could form.

The Commission recognizes that interested groups may have broader concerns that may include international trade negotiations, export credits or other international issues. The political, economic and social policies of recipient countries may likewise be of interest to many. Organizations formed to foster public understanding and support of foreign assistance should also be encouraged to include these broader topics and the activities of the international financial

institutions in their agendas.

The Commission also recognizes that the mobilization of various potential interest groups is unlikely to happen spontaneously. We therefore recommend that the President, with the support of the bipartisan leadership, call for a White House conference on the subject of U.S. security and economic assistance. Such a meeting would draw interested citizens together and provide the impetus for a cohesive and supportive network.

Continue Support for Development Education

The Commission noted the $1 million appropriated under the 1980 Biden-Pell Amendment to the Foreign Assistance Act to be used by AID for the support of development education. These funds have been used in the United States in the private, non-profit sector for outreach to the general public, work with the media and to stimulate curriculum building and youth development education. The Commission recommends that the Administration and Congress continue this effort and broaden its application to include all elements of foreign assistance and Third World relations.

Increase Assistance Levels

The U.S. foreign cooperation program is inadequately funded. This judgment is not based upon the percentage of GNP contributed relative to other donors. Nor is it based upon the Commission's observation that U.S. assistance levels — allowing for inflation — have fallen substantially in recent years. The judgment rests upon the need for resources to maintain our leadership role and meet our foreign policy objectives. These objectives —political, economic, strategic and humanitarian —have been outlined elsewhere in this report. Given the nature of the problems the United States will face in the less-developed world during the coming decade, either lesser objectives or more resources will be called for.

For the next decade, the economic and security outlook for most of the less-developed world is not encouraging.

On the security side, conflicts smolder in many parts of the world. Most arise from internal causes or regional rivalries, yet many have political and strategic implications for both East and West. This is the character of actual or potential disturbances in North Africa, the Middle East, much of Central America, Southeast Asia and the Horn of Africa. In addition, East- West competition increases the special dangers associated with the escalation of conflicts.

Economic stagnation may well persist and be a destabilizing factor in many developing countries during the 1980s. World economic growth in the coming decade will almost surely be slower than in the 1960s and early 1970s. The prolonged world recession (1980- 83), a heavy debt burden, a slow-down in the flow of private capital to developing countries and a possible decline in real official development assistance all suggest difficult times for many of these countries in the years ahead.

The present U.S. capacity to deal with foreign policy challenges inherent in these circumstances is circumscribed by the resources available for foreign assistance programs. As we become increasingly dependent on developing countries for markets and critical materials, and the world faces increasing threats to peace and stability, such inadequacy is inconsistent with our leadership role.

In part, the resource problem concerns the allocation of the existing volume of assistance resources among the developing countries and multilateral programs. Since the early 1970s, Egypt, Israel and the base rights countries have received most of the military assistance (75 percent in 1980-82) and much of the economic assistance (30 percent in 1980-82). This allocation reflects a broad consensus on U.S. foreign policy priorities. But in the process, it has reduced the our capacity to meet existing commitments to the multilateral banks and to deal with needs in the 30 to 40 other countries in which we have important strategic and political interests.

Moreover, it presents special problems in dealing with budget cutbacks. The smaller countries are squeezed the hardest and disproportionately whenever there is a budget cut. This means that the margin for adjustment to lower levels of cooperation is very limited for the great majority of countries in which our assistance program is an important instrument of U.S. foreign policy.

At the same time, several new initiatives are presently under discussion in Congress and in the Executive Branch: the Caribbean Basin initiative, an African initiative, greater concessionality in military assistance, increases in P.L. 480 and a new program of mixed credits to meet export competition and defend legitimate U.S. markets.

The present levels of funding for mutual cooperation programs, then, are inadequate. To meet U.S. short- and long-term foreign policy objectives laid out for the program, significant increases in real levels of assistance will be required. New initiatives will necessitate further budget increases.

Adopt Country Approach to Program Development

In addition to the issue of program lev-

els, the Commission devoted much attention to the policies that should guide the development of the foreign assistance program in order to make it as effective as possible in furthering U.S. objectives. In addressing this subject, the Commission examined at length the issue of program mix and, in particular, the issue of balance between the security and economic components of the program. This led to discussion on a number of subsidiary issues. For example, should ESF be considered as security or economic cooperation? Should all loans be added into the balance equation at full value, regardless of their degree of concessionality? From the examination of these issues, it became clear that conclusions depend critically on the assumptions made and the rules applied in aggregating the individual programs.

The deliberations of the Commission reflected clearly the strong views held by proponents of each category of assistance. Each side argued that in recent years the trend in foreign assistance favored the other side, and that in the U.S. national interest this should be reversed. The Commission recognizes that the aggregate balance between security and economic cooperation has been and continues to be one of the most divisive issues affecting the foreign assistance program.

In discussing this issue, the Commission returned repeatedly to the point that the optimum mix of component programs could vary widely from one country or region to another depending on conditions. For foreign assistance resources to contribute the most to achieving U.S. policy objectives, they should be applied with optimum effect in each recipient country. The Commission believes that this principle should be the primary policy guiding the year-by-year and long-term development of the program. Developed in this way, it will achieve the overall mix of security and economic assistance that best serves U.S. national interests.

Such an approach includes the combination of military, Economic Support Fund and/or Development Assistance programs suitable to each country or region according to its domestic needs, its absorptive capacity and U.S. short and long-term political, security, economic and humanitarian objectives. The Commission recognizes that proposals for P.L. 480 programs should be developed in this same context, but must be shaped, as they are now, by the need to manage domestic U.S. agricultural commodity programs and develop long-range markets for U.S. agricultural goods.

The role of the Peace Corps and U.S. support for private investment and private voluntary organizations, all of which contribute to long-term economic development, would also be important factors in the overall country approach. Functional priorities — such as adequate security, agricultural development, population and health — should continue to be weighed in the development of each country program and the overall programs that should be built from country and regional analyses. Estimates of the contributions likely to be made by the World Bank, Regional Development Banks and the United Nations Development Program (to which the United States contributes) — and to some extent the foreign assistance programs of other countries — should also weigh significantly in judging the optimum mix of U.S. bilateral assistance programs. There must be an iterative process, since the aggregate value of country programs must fit within some overall program and budget limitations. This approach places a premium on coordinating the various assistance efforts.

The Commission also considered the question of multi-year planning and programming. Although funds are authorized and appropriated on a year-to-year basis, programs for long-range economic and security development normally require planning projections of at least three to five years. Development projects and major military hardware acquisitions usually involve ongoing requirements beyond the initial year. Provision of commodities under Title I and Title II would improve with multi-year planning and programming for more orderly distribution. The Peace Corps would similarly benefit from such flexibility since it would provide continuity for multi-year volunteer projects.

The Commission recognizes the difficulty the Congress has with committing future year funds, but suggests that more multi-year programming be authorized.

The Commission is not able to predict the evolution of the mix of functional programs as a result of aggregating the optimum programs for each country. It does believe strongly that such an approach will lead to better decisions concerning the most effective mix of assistance programs for each recipient country. Hence, it will also provide the overall mix of security and economic cooperation that best serves the U.S. national interest.

The foregoing recommendation for fully integrated country assistance programs is closely related to our later recommendation for a single Executive Branch institution. Not only would both innovations result in better country programs, they would also provide the context and means for evaluating each program in terms of our broader global interests.

Ensure Carefully Integrated Programs for the Caribbean Region and Sub-Saharan Africa

Two regions of the world will provide a special challenge to the United States for the foreseeable future: the Caribbean region, including Central America; and sub-Saharan Africa. In the Caribbean we face a serious security challenge in an area that is indisputably of vital strategic importance to the United States, yet it also requires serious attention to deeply rooted economic problems which must be solved if long-term security interests are to be effectively served. In Africa there is an economic crisis of major dimensions that will call for a serious long-term response by the United States, the donor and the recipient countries. Failure to deal successfully with these problems can have serious security implications.

Support Policy Reforms

Experience has shown that resource transfers, be they economic or military, cannot be effective in the attainment of most U.S. objectives unless the political, economic, humanitarian and security policies of the recipient country are consistent with an effective use of these resources. In addition, there must be evidence of a political will to carry out needed reforms. U.S. cooperation should, to the extent possible, be tailored to support the evolution of policies that will ultimately result in open, self-sustaining economies and democratic societies. In some cases, reforms needed to stabilize economic and financial conditions, particularly in conjunction with IMF programs, may require austerity measures that have potential for heightened social and political conflict. We should seek to ensure that our assistance programs help to ameliorate these problems.

To be fully effective, it is important that the United States coordinate its efforts with other countries and multilateral institutions that promote development in recipient countries. Given its prominence and experience, the World Bank should take the lead in coordinating the participants more effectively.

It would also be desirable for the World Bank's executive board to hold regular review meetings that would focus on the recipient country's policies and how they impinge on the effectiveness and appropriate levels of bank assistance. Not only would such discussions facilitate coordination, they would be useful in their own right.

Encourage Human Resource Development and Institution Building

The development of human resources and institution building are as important as sound economic policies to the future of the developing countries and their use of economic assistance.

The Commission heard a number of views promoting various means by which our programs are or could be better directed in these areas. The following recommendations, which we found to merit specific attention, are not exclusive of other worthwhile initiatives. We encourage the continued search for programs that require relatively few resources but can make a major, even vital, contribution to development and security.

In the important area of agricultural development, we should continue to seek programs that support the development of agribusiness and agricultural institutions and the application of appropriate technology and experience at the scientific, technological, managerial and practitioner level. The Commission endorses the kinds of efforts being carried out through U.S. agricultural colleges and universities, cooperatives and the Peace Corps. Continuing attention should be given to enhancing efforts in this general area, drawing on the successes of U.S. experience at all levels in fields of expertise from that of the scientist to the farmer.

Training and education programs are a low-cost, high-payoff means of developing human resources essential to stimulating the economies of recipient countries and making them more secure. Over the years, scholarship and fellowship programs that bring foreign students to the United States to study have proved to be very effective, inexpensive means of providing foreign assistance to the less developed countries. In addition to providing recipients with education and professional training, these programs foster closer rapport with the United States and provide future leaders and managers with knowledge of American beliefs and views. They also have important indirect political benefits. We endorse expanded education programs to provide specialized advanced training.

Social structures that prevent the national development of a work force can significantly hamper economic development. The contribution that free trade unions make in the important area of human resource development is recognized in the Foreign Assistance Act. We should continue to support the strengthening of free trade unions and development strategies that are employment-oriented. A major consideration in providing assistance should be that recipients adhere to the conventions of the International Labor Organization, particularly those relating to freedom of association, discrimination and forced labor.

Increase Program Emphasis on Science and Technology

The virtual elimination of smallpox, the dramatic reduction of infant mortality through the introduction of oral rehydration therapy and the dramatic spread of the Green Revolution are only three examples of the dramatic impact that carefully selected science and technology programs can have on the quality of life at relatively low cost.

In recognition of its cost-effective potential and our comparative advantage in this area, the Commission recommends that increased programming emphasis be given to science and technology-related development assistance.

The Commission endorses programs of scientific and technical cooperation with developing countries that are tailored to their particular needs. Such programs should be available on a modest scale to middle-income and newly industrialized countries, which in turn should be encouraged to provide appropriate technical assistance to less-developed countries.

Promote the Private Sector

A vital private sector is essential to the development process in the whole range of developing countries — from the middle-income and newly industrialized countries to the least-developed. Their capacities and appropriate programs to encourage them may vary widely.

The Commission endorses the use of our bilateral and multilateral cooperation programs to promote policies that encourage indigenous private sector initiative, without which bilateral and multilateral assistance support cannot be fully effective.

We should continue to encourage the World Bank and its IFC affiliate to emphasize policy reform and focus their direct activities on private sector development wherever feasible. Our own programs should be similarly directed.

The U.S. private sector — business, banking, voluntary organizations and non-profit institutions — contribute to this process. Our policies and programs should be directed toward supporting them wherever appropriate.

Improve Evaluation

We recognize that the agencies currently conducting mutual cooperation programs conduct evaluations on a continuing basis and constantly strive to improve their quality. These evaluations, however, are almost exclusively of a technical nature dealing with program effectiveness in meeting its primary objective. What is lacking is a comprehensive evaluation process that assesses the political impacts, interrelates the projects and programs, both economic and military, and expresses a judgment on their effectiveness in supporting U.S. interests. The Commission wishes to emphasize that evaluation criteria must be incorporated in the program selection and development process because it is at that stage that program goals and the means for measuring their attainment must be established. Such a comprehensive evaluative capacity is needed to rationalize our planning efforts and provide the American public with better information. Evaluations of the MDB and UNDP programs should also be conducted unilaterally and in concert with other members as they relate to U.S. objectives in the regional and country-by-country development of programs. Note should also be taken of the consistency of such programs with the provisions of any IMF agreements.

Maintain Economic Support Fund Flexibility

The Commission believes that the flexibility of the ESF program must not be impaired by imposing specific goals or requirements on it. However, where possible, ESF should be programmed to further economic development and U.S. commercial objectives. The Commission notes that competing claims on ESF to support the Middle East Peace Agreements and countries where we have base rights agreements have led to a compression of funds remaining to support our interests in other countries. This problem needs to be addressed.

Increase Flexibility in the Development Assistance Account

Greater flexibility in the Development Assistance account would help ensure that a recipient's long-term development requirements can be met, while recognizing short-term constraints. While Development Assistance must continue to focus on addressing the longer-term constraints to development, too great a stress on projects aimed at ameliorating living conditions increases the risk of having very little long-term effect. Moreover, as is true with some military programs, some social projects can burden a country with recurrent costs greater than its economic ability to sustain, or encumber scarce management resources that could be used more productively elsewhere. Such situations are common in Africa, but also exist in other regions.

If greater flexibility is not achieved in the Development Assistance account, the Commission fears that administrators with overall responsibilities will continue to turn to meeting short-term financial needs through ESF and P.L. 480 pro-

grams to the detriment of longer-term development. The Administration should consider ways to make Development Assistance more flexible, including streamlining design and implementation procedures and removing excessive statutory requirements. Other means might include the provision of non-project assistance to specific sectors of the economy in conjunction with specific policy reforms. Where other countries or the MDBs are the primary donors, as in many African countries, we might find ways in which our assistance would support their long-term development projects. While we strongly endorse the objective of eliminating poverty, the stagnation or economic decline of many of the poorest countries clearly calls for far greater emphasis on self-sustaining economic growth. We believe that the above actions are possible within the spirit of the current legislation.

Support Development Objectives of P.L. 480

U.S. food assistance under P.L. 480 — the Food for Peace Program — serves multiple objectives: humanitarian relief and development; agricultural policy reform; balance-of-payments support; market development and commodity management for U.S. agriculture; and U.S. foreign policy goals.

Requirements for Title I concessional sales and Title II grants will continue in the years ahead. Special attention should be given to these needs. We believe that the United States should strive to use P.L. 480 and emergency assistance resources in advance of situations of acute or extraordinary need whenever possible. Caution should be exercised throughout to assure that P.L. 480 resources are not provided where they will be used to delay reform of agricultural policies or otherwise inhibit domestic agriculture.

The Commission also recommends multi-year programming of Title I and Title II commodities and, whenever possible, the use of P.L. 480 resources in combination with other forms of economic assistance to maximize development impact.

Increase Concessionality in Military Assistance

The Commission looked closely at the relation between our foreign cooperation programs and the problems posed by international debt. The external debt of several countries important to the United States has grown to the point where they are in danger of defaulting on repayment of their loans. The issue that directly concerned the Commission was: what could and should be done about the portion of these debts attributable to bilateral loans made by the U.S. Government?

For a few countries, U.S. foreign assistance loans represent a substantial portion of their foreign debt. For most, such loans constitute only a small fraction of the indebtedness of the recipient country. In either case, the failure of an assistance recipient to repay debts to the United States can be highly visible. United States law mandates certain sanctions for default or serious arrearage. Furthermore, the Congress must appropriate funds to replenish the FMS Guaranteed Loan Reserve Fund when payments cause it to be drawn down below a prudent level. The Executive Branch and the Congress are rightly concerned about this problem because failure to repay U.S. loans affects the integrity and credibility of the entire assistance program.

For a number of countries with large debt payment obligations, the United States still requires that FMS loans be extended at non-concessional interest rates while at the same time it is providing highly concessional economic assistance. For the 21 countries that received substantial amounts of both military and economic assistance in FY 82, the effective interest rate — including both grants and loans — was approximately 9 percent for military assistance and about 1 percent for economic assistance. Thus, one program is adding to the debt problems of these countries, while the other is seeking to alleviate them through favorable financial terms and economic improvement.

The Commission believes that the U.S. Government should consider the same economic factors in determining the concessionality of military assistance as it considers in determining the concessionality of economic assistance. If conditions in the recipient country justify concessional economic assistance, this should be a prime consideration in determining whether military assistance should also be concessional. While terms need not be the same, they should be determined in the context of an overall assistance policy for each country. The Commission recognizes that this policy will lead to extending more concessional military assistance worldwide, yet the Commission believes that such extension is justified to avoid adding further to the problems of U.S. assistance recipients with large debts.

To maximize the actual assistance provided at a given program level — and thus achieve the same net result with a smaller overall increase — the government should investigate the desirability of requiring the program to pay only the incremental cost of equipment, training and support provided by the Department of Defense. This principle is already firmly established in the case of the

International Military Education and Training (IMET) Program. However, in other areas there are instances where foreign assistance program funds must be used to reimburse the Department of Defense for a *pro rata* share of costs that DOD would have to bear whether or not there was a military cooperation program. This practice should be investigated and amendments made to the law where appropriate.

The other major aspect of this problem is existing debt. The Commission reviewed relief already available for dealing with existing debt, including the Retroactive Terms Adjustment (RTA) Program for selected least-developed countries, and the recent provision of Title III, P.L. 480, which permits the forgiveness of Title I loans. One alternative that has been suggested under the RTA program is acceptance of repayment of economic and military assistance loans in local currencies, which could then be used for development purposes through either government or private voluntary agency or other private sector programs. In both cases, new appropriations would still be required to repay the dollar obligations due to the U.S. Treasury. Moreover, very few of the least-developed countries have sufficient official debts to the United States to benefit significantly from this type of debt relief.

The Commission believes that the immediate priority should be to provide the degree of concessionality in future military and economic assistance most appropriate under the conditions in each recipient country. Relief of official debt for the poorest countries should be considered on a case-by-case basis.

Establish A Mutual Development and Security Administration

Throughout this report we have endeavored to demonstrate the importance of integrating currently fragmented programs into an effective whole. The objectives to be achieved by this integration are the development of country programs with an optimal mix of assistance resources; the establishment of a process that develops mutually reinforcing economic and security assistance programs and the installation of an effective and comprehensive evaluation program.

Furthermore, to achieve and sustain a mutual assistance program that is vigorous in its support of U.S. objectives, it must have the support of the Congress and the American public. The present program is procedurally and organizationally fragmented. It needs a comprehensive, analytical and institutionalized approach to problem-solving. Therefore we conclude that the present foreign assistance process within the Executive Branch must be reformed to improve cohesion and effectiveness. New organizations and procedures must be molded that will generate greater confidence in the American public for U.S. efforts in the foreign cooperation field. Furthermore, development of an effective program for each country requires a single organization that, through a single programming system, can achieve optimal program mixes.

The best of programs will not be effective unless they are supported by organizations and institutionalized procedures that facilitate improved coherence and rationality. This is our objective in offering the following recommendations.

These recommendations are based on the postulate that our economic and security cooperation programs are twin pillars supporting our foreign policy. Our organizational concept is intended to enable economic and security cooperation programs to reinforce each other to the benefit of both the United States and the recipient country. Our major procedural recommendation is designed to increase cooperation between two co-equal branches of government, the executive and the legislative.

Today program responsibility is fragmented in both the executive and the legislative branches. There is no single spokesperson in the Administration for the total foreign assistance program. The cacophony of voices representing various bureaucracies confuses even those who might wish to support our efforts. Informal attempts to rectify deficiencies are being made, and progress has been commendable. But this approach will always have limited scope and will rely heavily upon personalities for its effectiveness. We are convinced that a unified foreign cooperation institution is required before the system can be fully effective.

Having reviewed a number of alternatives, we have concluded that the most desirable approach to correct present organizational weaknesses is to amalgamate to the maximum extent possible those agencies, bureaus and offices that are involved in the mutual assistance program today. We are outlining only an organizational concept, leaving many specific arrangements to be worked out later by the Administration and the Congress. We are, however, clear on the following requirements:

- A single organization, which we propose to be named the Mutual Development and Security Administration (MDSA), will be responsible for (1) the budgetary control (including Congressional presentation) of the various components of the mutual assistance program (Development Assistance, Economic Support Fund,

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military assistance, P.L. 480, transfers to multilateral development banks) and those voluntary and mandatory contributions to the United Nations and related agencies that are part of economic development efforts; and (2) operational control over program and projects funded from Development Assistance, Economic Support Fund and available local currencies.

- A single director (with rank equivalent to that of a deputy secretary) whose chief, but not sole responsibilities will be to manage MDSA, represent the Administration in Congress and before the American public, issue policy guidance for those programs included in the mutual assistance program, and install comprehensive and unitary programming and evaluation systems.
- The new organization must report to the Secretary of State, who is responsible for the conduct of foreign affairs. As stated earlier, the mutual assistance program must support our foreign policy objectives. That can be accomplished most effectively by giving the manager the tools with which those objectives can be achieved. In stating our preference, we warn of two hazards: (1) the temptation to apply too many resources to the achievement of short-range political objectives and (2) the program imbalance that might result from having the director responsible for the operations of the development and ESF programs but not the execution of the military programs. Regarding the first peril, we believe that the MDSA must have a considerable degree of independence, following the model of the Justice Department-FBI relationship. On the second point, we doubt that our recommendations will necessarily result in an imbalance. On the contrary, the ability to orchestrate all programs is consistent with the country approach to the allocation of foreign cooperation resources.

Our recommendation would require transferring the Agency for International Development and certain parts of the Department of State to the new organization and incorporating personnel from the Departments of Defense, Treasury and Agriculture. The relationship of the Department of Defense to the Department of State should remain unchanged to assure that the Executive Branch will have defense and security considerations handled as they are now.

The functions of the Treasury Department and its relationship to the new MDSA present a more difficult problem. We are clear that responsibility for development of budgetary proposals for transfers to the multilateral banks must be lodged in the new organization. We do not foresee the need for the formal transfer of any other responsibilities, but believe that greater attention must be devoted by the U.S. Government to the developmental aspects of programs and projects conducted by the MDBs. We therefore suggest that Treasury Department guidance to U.S. executive directors on MDB activities, as it pertains to development efforts, have the concurrence of the MDSA, which would also perform technical project analysis for inter-agency review.

We recognize the unique nature of the P.L. 480 program, which has multiple objectives, and the underlying rationale that extends beyond the mutual cooperation program. We see little need to change present arrangements for program decision-making and coordination, which seem to be increasing in effectiveness, although we do see an enhanced role for the MDSA in this process. The Department of Agriculture, which would continue to play a major role in P.L. 480 deliberations and implementation, and MDSA must keep the following principles in mind: the reinforcing nature of P.L. 480 programs both for economic development and market expansion purposes; the desirability of utilizing the P.L. 480 program to broaden American public support for the mutual assistance program, particularly among the agricultural community; and the desirability of maintaining present Congressional committee jurisdictions on P.L. 480 programs.

Finally, in recognition of the close ties that the mutual cooperation program should have with those governmental agencies responsible for the stimulation of industrial exports, we recommend that the director of MDSA establish a small council. This council, consisting of the deputy and senior representatives from the Department of Commerce, the Export-Import Bank, the Overseas Private Investment Corporation, the Department of the Treasury and other comparable instrumentalities, would consider the promotion of American commercial interests through the MDSA.

The creation of MDSA should be accompanied by the elimination of the International Development Coordinaton Agency (IDCA), the Agency for International Development (AID) and the Office of the Undersecretary of State for Security Assistance, Science and Technology. We see no reason for any increase in government staffing due to our recommendation. On the contrary, the amalgamation of currently disparate operations should result in increased efficiency and perhaps even staff reductions.

The following major attributes applicable to MDSA and not to IDCA will highlight the dissimilarities between the

two organizations. The MDSA will

- be responsible for both economic and security assistance
- report to the Secretary of State
- have direct control over economic assistance and ESF program implementation and
- coalesce and integrate the various components of the mutual cooperation program.

Establish a New Consultative Group

Another major organizational recommendation concerns the establishment of a small, informal legislative-executive branch consultative group. It is absolutely essential that some means be found to increase Congressional confidence in the Executive Branch's stewardship of the mutual assistance program. Without resolution of this fundamental problem, the mutual assistance program is doomed to lower budget levels, stopgap funding, uncertainty and legislative restrictions that impede effective management.

We recognize that no Administration or Congress can be tied by the informal advice exchanged through a joint legislative-executive branch group such as we propose. Nor do we advocate changes in the present committee responsibilities for the mutual assistance program. The Commission recognizes that a substantial amount of consultation takes place today. However, we believe that consultation through existing channels needs to be strengthened and an additional mechanism should be established for consultation that will afford greater cohesion and effectiveness in the total governmental decision-making process.

This issue created a major dilemma for the Commission. We all agreed on the need for informal consultation. We also recognized the impossibility and the undesirability of establishing an unmanageably large group. The logical conclusion was therefore to recommend the formation of a group with a flexible membership, the composition of which would vary depending on the agenda to be discussed. We envisage a core group consisting of representatives of the Executive Branch and appropriate representatives of the committees of the House and Senate that are currently responsible for overseeing this program. It is important, however, to keep attendance at all meetings small enough to insure informality and confidentiality.

We believe that an agenda can be developed informally with each member of the group encouraged to suggest items for discussion. That agenda should include an annual review of the Administration's contemplated budget levels, discussions of forthcoming base rights or other negotiations that might eventually require special financial support and a review of contingency situations as they arise. This group can be particularly effective in determining the tolerable limits of budget requests and the possible mix of programs that will make the total more acceptable to Congress. It is vital that consultations occur with some frequency and that surprise Administrative action be avoided. Responsibility for ensuring maximum use of the consultative group should fall on the Executive Branch, although Congressional members must also contribute to its effectiveness by raising items for discussion.

In addition to increasing Congressional understanding, support and confidence in the management of the mutual cooperation program, it is the Commission's hope that as executive-legislative branch confidence grows through the operations of the consultative group, some present legislative restrictions might be deleted. Furthermore, we believe that the existence of a consultative group would enable Congress to have greater and more timely influence on the Administrative decision-making process, particularly on urgent and sensitive issues that require the use of mutual assistance program resources.

Chairman LUNDINE. Thank you very much. Now Dr. Hayes.

STATEMENT OF DR. MARGARET D. HAYES, EXECUTIVE DIRECTOR, ON BEHALF OF THE COUNCIL OF THE AMERICAS

Dr. HAYES. Thank you very much, Mr. Chairman. The Council of the Americas appreciates very much the opportunity to testify before your subcommittee. The subject that you are reviewing today, the impact of multilateral development bank programs on the private sector, is an issue that is obviously of great interest to members of the Council.

The Council itself is an association of U.S. corporations with interest in and investment in Latin America and the Caribbean. The membership includes Sears World Trade, other corporations involved in mining, manufacturing services, and most of the money center banks and most of our large U.S. accounting firms and a good number of consulting and law firms. Together the Council membership represents a very large proportion of total U.S. direct foreign investment in Latin America and the Caribbean.

The key interest that brings these firms together is their involvement in that region. I would also say that most of these firms are very closely involved with the private sector of Latin American countries and therefore much of what I have to say about the impact of multilateral lending institutions on the U.S. private sector, I believe, also holds true for the local private sectors.

In preparing this testimony today, the Council's Washington staff has surveyed a number of our corporate members asking them "How important is multilateral development bank financing to their operations in Latin America, and what could be done to improve opportunities for U.S. business in the region?"

For the most part my testimony is a resume of the responses of the U.S. corporate community.

Let me observe initially, however, that U.S. corporations are experiencing severe difficulties in their operations in Latin America. The chief cause of these poroblems is the prolonged recession that Latin America has been experiencing since the late 1970's and very sharply since 1982. The current economic situation is making it difficult for many companies to remain invested in the region in spite of their very great interest in remaining invested in the region.

In 1984 the Council of the Americas surveyed its memberhsip to understand more clearly the impact of the debt crisis. The survey showed that while U.S. companies' worldwide sales declined in 1981 and 1982, they began to rise slowly again in 1984. Sales by local affiliates of U.S. firms, that is the associates of U.S. firms operating in Latin America, fell from $28 billion in 1981 to $21.5 billion in 1983, and were expected to fall to the $16 billion range by the end of 1984.

Sales by U.S. firms into Latin America fell by one-third from $3.6 billion to $2.4 billion in the same period.

Latin America's share of U.S. corporate worldwide sales fell from 7.5 percent in 1980 to less than 5 percent in 1983.

This decline is especially worrisome to corporate members, they warn us because when sales for a company fall below 5 percent of corporate worldwide sales, that segment disappears from the sight

of top level management. New funds, key management resources, are simply not made available.

Thus, the declining level of U.S. corporate involvement in Latin America may have long-term implications for the return of investment dollars to the region and for the region's own economic recovery.

Mr. Chairman, I would like to have the Council report included in the record as an attachment to my testimony for the use of the members.

Chairman LUNDINE. Without objection, it will be included.

[The Council of the Americas report referred to follows:]

COUNCIL OF THE AMERICAS

AN AFFILIATE OF THE AMERICAS SOCIETY INC 1600 SIXTEENTH ST NW SUITE 600 WASHINGTON DC 20036 202 [illegible]

DEBT, ECONOMIC CRISIS
and
UNITED STATES COMPANIES
in
LATIN AMERICA

A Report of Responses to a Council
of the Americas Survey of 52 Companies Invested,
Trading and Operating in Argentina, Brazil, Mexico and Venezuela

September 1984

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The Council of the Americas is an association of over 180 major U.S. companies with investment, trading, banking, and servicing activities in Latin America. It seeks to improve the understanding between governments and private sector representatives of the contribution that private initiative can make to economic growth.

PREFACE

This report embodies interpretations of survey responses from 52 Council of the Americas member companies covering about 150 operations in Argentina, Brazil, Mexico and Venezuela. It reflects data as current as mid-1984, company projections to end-1984 and opinions concerning subsequent years. The number of operations is not constant over the period surveyed (1981-1984) because some were closed, opened or lost through acquisitions. Not all companies answered each survey question.

The data were submitted by the companies in confidence to the independent accounting firm of Arthur Andersen & Co. for statistical compilation and analysis of certain responses. The Council of the Americas expresses appreciation to them.

Throughout this report "company" and "parent" refer for convenience to both the parent U.S. company and to other affiliates located outside the countries under study. The terms "affiliate", "local affiliate" or "subsidiary" refer to companies located in one of the four countries.

There is occasional reference to a similar but not directly comparable survey by the Council released last year. Brief comments on key issues and policy questions which arise from the findings appear at the end of the report. The report also makes occasional observations intended to place in context some of the trends shown by the data.

For more detailed study, copies of both the questionnaire and last year's report may be obtained from the Council of the Americas.

SUMMARY OF FINDINGS

The impact of the continuing economic crisis in Argentina, Brazil, Mexico and Venezuela on the investment, financing and trade flows of 52 major U.S. companies is summarized as follows:

In the context of global operations, these four Latin American markets are becoming less significant for the responding companies as
- -the investment climate worsens or stagnates
- -sales (as US$) continue to decline
- -cutbacks outpace expansions
- -total employment is down 11% from 1981.
- -return of nominal GDP growth foreseen by most in 1985 and later.

Investing

- o CORPORATE DEBT: Little converted to equity
- o PROFITS: In US $, some recovery; deteriorating in Venezuela
- o DIVIDENDS: Over half report none for three years
- o FOREIGN EXCHANGE ACCESS: Tougher in Argentina and Venezuela; easing in Brazil and Mexico

Trading

- o LOST SALES: Debt-related trade problems directly causing loss of US exports
- o TRADE CREDIT: Shifting to costly secured terms for third parties
- o COUNTERTRADE: Minor factor in current trading
- o EXPORTS: More possible from these countries with only modest investment

Self-Financing

- o SUPPORT FOR AFFILIATES: Under moderate stress, expanding in Venezuela
- o DOLLAR FINANCING: Less from banks, more from parents
- o TRADE CREDIT: Terms tightened to affiliates
- o FINANCING LIMITS: Being reached by 60% of respondents

The companies have downgraded their expectations for these four debt burdened markets. A few operations have been closed. Most will hold on, but make only a minimum effort to stay. Staying is costing the companies dearly. Many say they will not add more to their self-financing programs. The companies, it seems, are having trouble ascertaining their future in Latin America.

THE RESPONDING COMPANIES

The 52 responding companies represent a broad spectrum of industrial, extractive, agribusiness and service sectors through about 150 operations in Argentina, Brazil, Mexico and Venezuela. As a group, they had global sales of U.S. $442 billion in 1983. The group contains a few very large corporations, a sizable number of medium sized multinationals and a handful of smaller firms.

Based on the survey sample, Latin American operations appear to be declining in importance for the responding companies as a group. Business, in terms of sales (as US$) to and within the region, has declined from 7.5% of collective world-wide sales in 1981 to about 5.2% in 1983. Assuming total world-wide dollar sales growth of 5%, further reduction to 3.8% is anticipated for 1984. It is occasionally observed that when sales for a segment of a company fall below roughly 5% of total company sales, that segment disappears from sight for top corporate management.

Sales by the companies from outside the area to local affiliates and to third parties in Latin America have dropped each year from 1981 to 1984. Overall, the rate of decline has been increasing over the four year period, with steeper declines more recently.

SALES TRENDS
US $ Billions

	1981	1982	1983	1984E*
Total company world-wide sales	$424.1	$420.8	$442.2	Not asked
Local affiliates' total sales in all of Latin America	$28.4	$26.5	$21.5	$16.5
Total sales from outside Latin America into Latin America to both local affiliates and local third parties	$ 3.6	$ 3.3	$ 2.8	$ 2.4
Of the line above, sales to local third parties	$ 1.8	$ 1.7	$ 1.6	$ 1.1

*E = Expected

GDP RECOVERY FORECAST

For the last several years most of Latin America has experienced negative growth in Gross Domestic Product (GDP). The companies were asked when they foresee these economies beginning to grow again with growth stipulated as 1.0% p.a., i.e. the beginning of a turnaround.

Initial growth is foreseen in 1985 in all four countries by the single largest number of responses (68). Such recovery was seen delayed to 1986, however, by 45 responses and to 1987 by 18 responses. Mexico shows the best indication of an early return to growth. There was no consensus for Argentina's turnaround point, while for Brazil and Venezuela indications pointed to 1985 and 1986 for restoration of growth.

GDP GROWTH RECOVERY
+1% p.a. = Growth

	1984	1985	1986	1987	1988	Later
Argentina	10	10	7	7	2	3
Brazil	2	19	17	4	0	4
Mexico	7	23	9	3	0	0
Venezuela	2	16	12	4	1	2

It should be noted that a nominal upturn after severe negative GDP trends in these countries does not constitute a recovery.

INVESTMENT CLIMATE

For over half the operations, the investment climate has deteriorated in these countries since mid-1982. One-third reported "no change." Few reported an improved climate.

INVESTMENT CLIMATE CHANGE
By Operation Since Mid-1982

	No Change	Improved	Deteriorated
Argentina	12	4	22
Brazil	18	4	23
Mexico	16	9	17
Venezuela	9	1	26
Total	55	18	88

Companies checked those factors, by country, which contributed most to a change in climate, if they reported a change. Where a change for the worse was reported, the top five factors are listed below by country. The parenthesis gives the number of times the factor was cited.

Argentina

Local economic conditions (18)
Price controls (10)
Political stability (7)
Foreign exchange access (6)
Remittance restrictions (2)

Brazil

Local economic conditions (22)
Price Controls (11)
Foreign exchange access (8)
Remittance restrictions (4)
Political stability (2)

Mexico

Local economic conditions (16)
Foreign exchange access (7)
Price controls (5)
Discrimination against MNCs (4)
Equity ownership limits (1)

Venezuela

Local economic conditions (21)
Foreign exchange access (13)
Price controls (9)
Remittance restrictions (4)
Others (3)

CUTBACKS, EXPANSIONS, CLOSEDOWNS

About 40% of the operations in the four countries report "no change" in size and scope of their activity during the past 12 months, which implies stagnation. For the others, curtailment of operations dominated, although some reported expansion. Four operations were closed.

In the coming 12 months, more than half expect "no change." The rest foresee more expansions than cutbacks.

OPERATION SIZE CHANGES
Before/After Mid-1984

	No	Closed	Cutback		Expanded	
Past 12 months	Change	Down	Little	Lot	Little	Lot
Argentina	17	2	7	2	5	1
Brazil	14	0	12	3	10	4
Mexico	17	1	9	4	11	3
Venezuela	16	1	7	10	5	1
	64	4	35	19	31	9
Next 12 months						
Argentina	18	0	3	2	7	3
Brazil	25	1	2	1	13	2
Mexico	19	0	3	1	14	4
Venezuela	18	1	5	3	9	0
	80	2	13	7	43	9

The reasons indicated for cutbacks or closedowns were:

Past 12 Months (113)	Argentina	Brazil	Mexico	Venezuela	Total
Local Market Recession	7	12	10	13	42
Generally Poor Outlook	3	6	6	7	22
Inability to Compete Locally	2	4	3	3	12
Import Restrictions	3	2	2	4	11
Foreign Exchange Unavailable	1	2	2	6	11
Next 12 months (41)					
Generally Poor Outlook	4	2	3	6	15
Other Government Action	2	1	3	2	8
Local Market Recession	2	1	2	2	7
Inability to Compete Locally	0	1	3	2	6
Import Restrictions	1	0	1	1	3
Foreign Exchange Unavailable	0	0	1	1	2

The ( ) indicate total reasons checked; not all reasons are shown here.

EMPLOYMENT

Total employment has fallen from 1981. The most severe drop of 24% occurred in Venezuela, mostly in 1983. Brazil shows employment holding steady in spite of the recession there. Employment in Mexico has fallen 18% and leveled off. There is notable recovery in Argentina in 1984 after dropping lower in the two prior years.

EMPLOYMENT LEVELS
Aggregate Direct Employment

	1981	1982	1983	1984
Argentina	27,146 (24)	23,700 (26)	23,498 (27)	26,426 (27)
Brazil	101,780 (33)	99,814 (35)	95,749 (35)	95,280 (36)
Mexico	63,670 (30)	57,320 (32)	52,049 (31)	51,927 (31)
Venezuela	21,882 (30)	23,245 (31)	17,194 (28)	16,499 (29)
Totals	214,478	204,079	188,490	190,132

Parenthesis indicates number of responses.

Not all responding companies provided employment data. Thus employment is understated to an indeterminate degree. Since more companies furnished data for 1984 than for earlier years, there is probably a further understatement in the more recent drop in employment.

INVESTING

DEBT CONVERSIONS

Since the beginning of 1983, 125 of 148 operations have not converted debt to equity, notwithstanding government encouragement. Thirteen converted "a lot" of debt to equity and 10 converted "a little." Brazil led with 11 of the 23 conversions, seven of them converting "a lot" to equity.

EARNINGS TRENDS

The earnings trend index in Argentina and to a lesser extent in Brazil has improved from 1981 levels, but has fallen in Mexico and Venezuela. Mexico has shown recovery, though, from the severe drop in 1982, while Venezuela continues a downward trend.

Since bottomline results are confidential, absolute dollars were not requested. Instead, an index with 1981 as the base year was used to reflect trends in dollar earnings. That was a pre-crisis year for each country except Argentina. Devaluation is, of course, a prominent factor in understanding dollar profit declines as well as dollar sales declines.

EARNINGS TRENDS
By Index, 1981=100

	1981	1982	1983	1984E*
Argentina	100	177(24)	153(24)	190(24)
Brazil	100	121(23)	81(28)	110(24)
Mexico	100	74(22)	80(28)	87(26)
Venezuela	100	111(24)	81(18)	66(21)

* E = Expected. Parenthesis indicates number of responses. Not all companies responded to each question.

REMITTANCES: EARNINGS / ROYALTIES

Over half the reporting companies indicated no earnings remittances (i.e. dividends) in 1982, 1983 or 1984, with the percentage increasing for the most part. Venezuela represents the worst case.

"NO REMITTANCE" –

	1982	1983	1984E*
Argentina			
Responses stating "no remittance"	19	16	20
As % of total responses	54%	55%	65%
Brazil			
Responses stating "no remittance"	21	22	24
As % of total responses	57%	59%	62%
Mexico			
Responses stating "no remittance"	21	20	23
As % of total responses	66%	62%	66%
Venezuela			
Responses stating "no remittance"	15	20	21
As % of total responses	68%	71%	70%

*E = Expected.

For those reporting some remittances, an index (1981=100) was used rather than absolute dollars. The index level trend is scattered, with Argentina, Brazil and Mexico up over 1983 and Venezuela sharply down.

A separate analysis of 1983 earnings reports from all countries shows remittances (dividends) from affiliates were not expected (63 instances) or were often hindered if attempted (21 cases), although some reported dividends "on target" for that year (35 instances). In seven cases a dividend in excess of plan was made to avoid anticipated devaluations. This demonstrates low expectations for receipt of dividends from 1983 earnings, due primarily to exchange and remittance limits and the need to retain funds for working capital.

An analysis of royalty obligations for 1983 shows that, where owed, they were paid in full in 39 out of 60 cases. In the other 21 instances remittance obligations were constrained to some degree. Exchange limitations were given as the major constraint.

FOREIGN EXCHANGE ACCESS

By country, acquisition of exchange was more difficult in Argentina and Venezuela, while Brazil and Mexico show improvement. Overall, better than 44% of the operations indicated that acquiring foreign exchange in mid-1984 was at least a little easier than in the most difficult period of 1983. It appears that the ability to acquire foreign exchange may differ from industry to industry and even company to company.

ACQUIRING FOREIGN EXCHANGE
1983 vs. Mid-1984, by Operation

	Easier		Harder		No	
	Much	A Little	Much	A Little	Change	Totals
Argentina	1	9	8	7	8	33
Brazil	5	18	7	5	6	41
Mexico	3	21	2	7	8	41
Venezuela	1	8	13	5	5	32
	10	56	30	24	27	147

U.S. RULE CHANGES PROPOSED

The companies were asked to suggest that change in, or addition to, United States rules or policy which would be most helpful to overall corporate results from their operations in each country. Responses are listed at the back of this report in Appendix A. Their proposals show a wide diversity of concerns.

OPIC COVERAGE

OPIC insurance coverage currently plays no role in 107 of 112 operations according to the survey. Looking ahead, companies foresaw OPIC coverage could play a role in 22 of 93 operations. Responses were fairly uniform for each country.

NEGATIVE PLANNING FACTORS

Factors currently having the greatest negative influence on investment planning for their local affiliates are listed below in order of overall frequency of mention.

INVESTMENT PLANNING
Negative Factors

	Argentina	Brazil	Mexico	Venezuela	Total
Local Economic Recession	11	24	23	17	75
Price Controls	13	17	11	15	56
Depressed Product Demand	7	10	13	7	37
Lack of Foreign Exchange	6	9	4	8	27
Remittance Restrictions	8	9	2	6	25
Cost of Borrowed Funds	4	8	6	1	19
Border Closing (Imports)	4	7	6	2	19
Worldwide Economic Trouble	1	5	6	4	16
Negative Bureaucratic Bias	2	1	2	7	12
Industry Specific Regulations	1	1	7	2	11
Trade Financing Difficulties	2	3	2	2	9
Political Instability	4	3	0	1	8
Overvalued Currency	1	1	1	2	5
Competition	1	1	1	0	3
Performance Requirements	0	0	3	0	3
Technology Protection	1	1	1	0	3
Others	1	2	1	1	5

The first and third most frequently noted factors are symptomatic of continuing economic stagnation. A wide diversity of companies is distressed by "price controls," the second ranking factor.

"Lack of foreign exchange" ranks only fourth among negative factors, but if combined with "remittance restrictions," the two rank third.

It would seem that economic stagnation is a higher business concern currently than government rules or policies.

TRADING

LOST EXPORT SALES

U.S. export trade from parent companies to either affiliates or non-affiliates in the four countries has been lost. Lack of financing, unacceptable financing cost or unwillingness to assume the risk of unsecured trade credit transactions has meant some degree of lost U.S. export trade sales according to 25% of the responses. Lost sales were reported by percentage of expected total sales for the 12 months ending mid-1984. The dollar amount of such losses was not asked.

LOST EXPORT SALES
Mid-83 to Mid-84

	Some Lost	Average %Lost	None Lost	No Such Trade	Total
Argentina	(12)	51% (9)	(10)	(13)	(35)
Brazil	(9)	21% (8)	(12)	(18)	(39)
Mexico	(4)	35% (2)	(15)	(15)	(34)
Venezuela	(12)	45% (8)	(11)	(14)	(37)

Parenthesis indicates number of responses. A few companies which reported lost sales did not provide the percentage of loss.

SECURED TRADE CREDIT - NON-AFFILIATES

Shipments from parents to non-affiliates, where secured terms are normally prominent, shifted toward even greater use of secured trade credit terms between end-1981 and mid-1984. The end of 1981 serves as a pre-crisis comparative checkpoint.

SECURED TRADE: NON-AFFILIATES
As % of Total Shipments

	Argentina	Brazil	Mexico	Venezuela
End-1981	53%	50%	34%	32%
Mid-1984	87%	50%	50%	73%

In 1984 the secured transactions chiefly comprised confirmed letters of credit with some prepaid shipments. Virtually no shipments were made under official export credits by these companies.

Secured trade transactions have a higher cost than unsecured trade. Shifts of the magnitude reported reflect a response to the debt-induced trade difficulties of the region.

Argentina and Venezuela reflect serious trouble with trade flows, Mexico has seen some tightening, while Brazil's report would indicate business as usual.

UNSECURED TRADE CREDIT - NON-AFFILIATES

Although not directly comparable, survey data a year ago showed that willingness to ship to third parties was dropping. The reports this year show a mixed trend. Greater credit is being extended to Venezuela, perhaps involuntarily because of exchange access difficulties, and to Brazil. Tightening is in evidence in Argentina. Mexico is unchanged from 1981 levels.

Outstanding unsecured trade credits are expressed in terms of the average of months of shipments outstanding at the then prevailing levels and in terms of the average of dollar amounts outstanding.

UNSECURED CREDITS: NON-AFFILIATES

	End-1981	Mid-1984	% Change
As Months' Shipment			
Argentina (9)	5.6	4.1	-27%
Brazil (12)	4.3	5.0	+16%
Mexico (11)	3.1	3.1	0%
Venezuela (10)	3.7	6.3	+70%
As Average U.S. $ Millions Owed			
Argentina (14)	$ 4.3	$ 3.0	-30%
Brazil (15)	$40.0	$ 6.5	-84%
Mexico (14)	$50.1	$17.9	-64%
Venezuela (13)	$10.7	$ 9.2	-14%

The ( ) indicates total number of responses.

TRADE PRACTICES

Countertrade in its various forms is not being used by the companies either for U.S.-sourced sales to the countries or for local affiliate export trade. For Argentina no such trade is conducted. For Brazil, two companies practice countertrade, one for a major portion of its trade. For Mexico, six companies use countertrade, two of them for a major portion of this trade. For Venezuela, three companies report only nominal use.

Relatively minor portions of the affiliates' 1984 export trade comprise exports that are nontraditional for them and which are being made to gain otherwise unobtainable foreign exchange. For Argentina, 8 companies are so engaged for an average of 8% of their exports, while in Brazil 11 companies average 15% and in Mexico 11 companies average 18%. No such exports are reported from Venezuela. The fact that such exports appear at all is a reminder of the impact the countries' economic distress is having on trade.

Higher portions of the affiliates' 1984 export trade result from host government pressure, mandatory regulation or exchange limits: Argentina 9%, Brazil 40%, Mexico 48% and Venezuela 28%. These percentages are the average of the reports from 8, 17, 16 and 8 companies respectively.

High debt countries are said to be utilizing payments unions and clearing arrangements to settle foreign currency accounts between governments on a bilateral or multilateral basis. Some private trade is reportedly being incorporated into or making use of such arrangements. However, very few companies reported benefiting from clearing arrangements. Eleven Brazilian operations reported varying degrees of benefit: three "greatly", four "some" and four "slightly". The other countries showed even less such activity.

Nearly 40% of the operations are encountering European and Japanese competitors who are engaging in predatory trade practices by utilizing various types of official assistance to win high-debt country markets from U.S. companies.

PREDATORY TRADE PRACTICES
Number of Operations Affected

	Not at all	Slightly	Some	Greatly
Argentina (34)	19	3	11	1
Brazil (40)	22	5	10	3
Mexico (39)	26	5	7	1
Venezuela (36)	24	2	8	2

The parenthesis indicates the total number of operations reported for each country.

EXPORT POTENTIAL

Many companies state that continuing real devaluations would encourage more export sourcing from the indicated country. The greatest potential appears in Brazil and Mexico. For many, factors other than continuing real devaluations would control export sourcing decisions.

DEVALUATION COULD PROMPT EXPORTS
Number of Operations

	Yes	No	Other Factors Override	Total
Argentina	4	9	18	(31)
Brazil	18	4	19	(41)
Mexico	20	7	14	(41)
Venezuela	7	14	11	(32)
	49	34	62	145

Moreover, while companies report that their local production facilities are currently oriented to the local market rather than to exports, they say that over 60% of the local operations could export more without significant added local investment, particularly from Brazil and Mexico. Where added local investment would be needed, 23 operations reported such increases would average between 17% and 32%, with the higher level called for in Brazil.

LOCAL SOURCING

Nearly 70% of the operations have to some degree shifted away from importing to local sourcing of supplies since mid-1982 to sustain their operations. This shift is presumably occurring in the absence of foreign exchange availability or in response to higher local content requirements. It is probably not a voluntary shift.

SHIFT TÓ LOCAL SOURCING
Number of local operations shifting

	Greatly	Some	Slightly	Not At All	Total
Argentina	3	9	4	14	30
Brazil	6	19	7	8	40
Mexico	4	17	8	11	40
Venezuela	1	11	6	12	30
	14	56	25	45	140

SELF-FINANCING

Corporate self-financing is being strained to its limits by conditions in the region. The survey, in probing self-financing, made a nontraditional analysis of corporate activity. The concept of self-financing is not normally much thought about; however, as other sources come under strain, the companies have had to provide financing well above normal levels, throwing a spotlight on this subject.

Companies finance their affiliates (that is, self-finance) through hard currency loans from the parent, intercompany account build-up, forebearance in dividend and other remittances, back-to-back loans, parent company bank guarantees and other types of intercompany debt.

It would appear that at the beginning of the economic crisis in each country companies greatly increased self-financing to sustain local operations as other sources of financing were curtailed and as the need for financing increased. As the crisis has continued, and becomes more evidently long-term in nature, the strain of such higher than normal levels of self-financing begins to show and willingness to further self-finance is reaching its limits.

The survey sought to determine whether corporate self-financing, excluding parent company loans, has been expanding or contracting. Caution is advised. Interpretation of the question was probably not uniform and roughly half the companies did not answer. Still, data here provide useful general impressions.

For the responding companies, increased self-financing of their local affiliates has continued, but to a lesser degree in the first half of 1984, in Argentina and Mexico. In Venezuela it has expanded sharply.

CORPORATE SELF-FINANCING
Increase/Decrease as %

	End '81/End '83	End '83/Mid-'84
Argentina	205%(14)	11%(11)
Brazil	39%(18)	22%(15)
Mexico	123%(15)	14%(13)
Venezuela	65%(11)	126%(9)

These findings, which square with those on the next page, raise the question of whether companies are reaching the limits of their willingness to further self-finance.

DOLLAR LOANS

Local affiliates borrow dollars (hard currency) from banks, non-banking third parties and from foreign affiliates including the parent company. Normally banks account for considerably more lending than the other sources, although the multinationals provide self-financing in the form of loans to local affiliates to a significant degree. (They provide added self-financing in other forms, as shown elsewhere.) The parent companies also guarantee some bank borrowing by their affiliates.

Of dollar borrowing by local affiliates, about 35% is owed to parents (and other foreign affiliates) at mid-1984. Less than 8% of this was past due more than 90 days. A year ago these ratios for a similar but not directly comparable set of companies were 10% and 48%, respectively. This means the companies appear to be providing relatively more financing now and the banks relatively less. Overdue payments to the banks were running at 10% of total loans, up from 6% a year ago. Overall, about 28% of the bank loans are reported as parent company guaranteed, although the level differs by country.

DOLLAR LOANS
Owed by Local Affiliates, Mid-1984
(US $ Millions)

	Owed Today	90 + days Past Due	Percent Past Due	Amount Guaranteed	Percent Guaranteed
Argentina (18)					
Owed to banks	$ 184	$ 50	27%	$73 (6)	40%
Owed to parent*	$ 55	$ 9	16%	xx	xx
Brazil (24)					
Owed to banks	$ 446	$ 0	0%	$ 81 (7)	18%
Owed to parent*	$ 812	$ 5	1%	xx	xx
Mexico (26)					
Owed to banks	$1,271	$ 0	0%	$367 (10)	29%
Owed to parent*	$ 177	$ 29	16%	xx	xx
Venezuela (19)					
Owed to banks	$ 462	$ 182	39%	$181 (9)	39%
Owed to parent*	$ 219	$ 56	26%	xx	xx

Parenthesis indicates number of responses. *Includes other foreign affiliates.

Looking at each country, Argentina and Venezuela present the greatest loan payment problems and have drawn the higher levels of parent guarantees. Unless companies have simply failed to respond, Brazil and Mexico show an excellent record of payments to banks. Not all companies have outstanding dollar loans.

UNSECURED TRADE CREDIT - AFFILIATES

A Council of Americas survey last year, while not directly comparable, showed parent company trade credit to local affiliates was expanding as companies ran up their intercompany merchandise open accounts. The reports this year show an opposite trend. Expressed as months' shipments, the extent of credit outstanding has been tightened over 1981 levels. Viewed through the average of absolute dollar credit outstanding, self-financing has also been tightened, except for Brazil.

UNSECURED CREDITS: AFFILIATES

	End 1981	Mid-1984	% Change
As Months' Shipments			
Argentina (12)	7.5	6.4	-14%
Brazil (18)	6.8	5.7	-16%
Mexico (22)	7.1	4.8	-32%
Venezuela (13)	11.9	7.5	-36%
As Average U.S. $ Millions Owed			
Argentina (14)	$14.8	$ 4.4	-70%
Brazil (19)	$ 3.8	$ 6.1	+60%
Mexico (26)	$63.3	$ 5.3	-91%
Venezuela (16)	$21.0	$13.7	-34%

SECURED TRADE CREDIT - AFFILIATES

At the end of 1981, which served throughout as a pre-crisis comparative checkpoint, virtually 100% of shipments from parents to affiliates were on unsecured trade credit terms. Today (mid-1984) there is a shift, reducing unsecured terms on average to a percentage of total shipments as follows: Argentina 81%, Brazil 92%, Mexico 87% and Venezuela 70%. Secured transactions, which account for the balance, are done either through prepaid cash or confirmed letters of credit.

SELF-FINANCING LIMITS

The survey sought to determine explicitly whether there is a limit to corporate self-financing beyond which a company is unwilling to go.

A year ago a solid majority of a similar, but not directly comparable, group of companies said they did not expect to reach self-financing limits. For Argentina, 79% so reported, for Brazil 88%, for Mexico 64% and for Venezuela 74%.

As of mid-1984, however, the answers have reversed dramatically. A solid majority now report they have reached or in the next 18 months expect to reach their self-financing limit. For Argentina, 69% so report, for Brazil 62%, for Mexico 58% and for Venezuela 60%.

SELF-FINANCING LIMITS
Number of Operations, as of Mid-1984

	Already Reached	Will Reach By End '84	Will Reach By End '85	Do Not Expect To Reach
Argentina	14	1	5	9
Brazil	14	2	7	14
Mexico	16	0	5	15
Venezuela	14	1	3	12
	58	4	20	50

Reports from 50 operations state they do not expect to reach their limits of financing. This would tend to suggest they are willing to extend support to their operations to any extent necessary to remain sucessful in a tough operating environment. It may also reflect the high cost of closing an operation or a decision to simply hold out on a minimum footing until conditions improve.

APPENDIX A

PROPOSED U.S. RULE CHANGES
(See page 8)

- U.S. to assume a more active role in renogotiation of foreign debt and reducing level of interest rates.
- Eligibility for EXIM financing/insurance
- Reduction of the federal deficit by controlling government spending would reduce interest rates and improve business climate in these countries.
- Enforcement of existing customs regulations - remove contraband.
- Non EXIM bank & FCIA insurance export programs for dollar availability.
- FAS #52 Deconsolidation operating results - report on a cash basis only.
- Foreign Corrupt Practices Act - modify.
- Those pertaining to exchange rates for valuing assets and performance.
- Elimination of countervailing duties against Brazilian exports.
- Allow continuance of export incentive programs.
- EXIM support of intercompany transactions.
- Modification of rules for application of foreign tax credits against U.S. tax on foreign earnings.
- Loosening of Government bureaucratic requirements.
- More favorable tax credit treatment.
- Reduction in U.S. interest rates.
- Tariff reductions on certain chemicals.
- Requirement to prove injury for imports from Mexico to prove dumping charges.
- FCPA/FAS# 13 clarify.
- Elimination of Tariffs.
- None - Problems are within local countries.

Dr. HAYES. Thank you very much.

The prolonged recession in Latin America has had a direct impact in the United States. The Commerce Department estimates that the downturn in Latin America has cost some 700,000 U.S. jobs. The World Bank, which is more austere, calculates that some 400,000 U.S. jobs have been lost. In any case, the dimensions are tremendous.

Companies that once enjoyed substantial markets in the region, particularly manufacturers of heavy construction equipment, were hard hit. J. I. Case Co.'s export sales to Latin America have declined 68 percent since 1980. In 1982, Deere and Company's overseas operations experienced the loss of $60 million after years of showing a profit. Caterpillar's sales to the region, to Latin America, fell by more than two-thirds between 1980 and 1983 from $903 million to $266 million.

Caterpillar classifies business in Latin America as quote "extremely depressed."

With commercial bank financing reduced to a trickle, and most of the countries of the region graduated from our diminishing list of concessional assistance, financing through official sources, including the multilateral development banks, has become extremely important to them. It is virtually the only source of financing now available to sustain development in the region.

When our members were asked whether the multilateral development bank funding helps U.S. companies to maintain sales in the region, the answer for most was an emphatic "yes." This is true for companies like Caterpillar which finds that the banks are crucial to their business in Latin America, and which expects this situation to remain for years to come.

The Yacyreta hydroelectric project in Argentina and Paraguay, supported by World Bank and Inter-American Development Bank funds, has led to $25 million in sales for Caterpillar. Recently, Caterpillar won a contract in an IDB project for Paraguay that will result in $2 million in sales.

An MDB funded pipeline project in Colombia yielded several million dollars in sales. In Equador, a World Bank project to improve roads and infrastructure led to the purchase of over $1 million in Caterpillar equipment. These projects would definitely not have happened without financing from the MDB's.

The percentage of procurement from IDB and World Bank projects that goes to U.S. companies roughly parallels the U.S. share in those institutions. In the Inter-American Development Bank, the U.S. paid-in capital share is 34 percent, and U.S. companies have received 15 percent of all contracts awarded by the IDB and 35 percent of all contracts awarded to the nonborrowing countries, that is the developed countries.

This is more than any other IDB member has received.

In the World Bank where the U.S. paid-in share is 20 percent, U.S. companies have been awarded about 19 percent of contracts. Between 1980 and 1984 U.S. companies were awarded $376.5 million in contracts through the IDB and $4.2 billion through the World Bank and IDA.

Moreover, it is estimated that the United States gets $3 back for every $1 contributed to all multilateral lending agencies. For every

dollar contributed to IDB, the United States gets slightly over $2. The return for taxpayer contributions to the banks is a much leveraged level of purchases for Bank projects.

For a good number of reasons, U.S. companies do miss out on some important business opportunities available through the MDBs, and the U.S. share of procurements, while remaining substantial, has declined recently.

Until 1979 the U.S. share of World Bank procurement disbursements was over 25 percent. Between 1980 and 1984 procurement disbursements amounted to $3.5 billion, but this represented only 9.7 percent of total disbursements in nonborrowing countries.

Between 1973 and 1976 U.S. companies won over 50 percent of contracts awarded through the IDB, that figure declined between 1977 and 1980 but rose again to 40 percent in the 1981 to 1984 period. The biggest factor in the declining share of U.S. companies' participation in development bank projects is the high cost of the dollar.

In addition, increased competition for contracts from developing countries themselves also contributes to lower U.S. share of the pie. Developing countries' suppliers accounted for 14.9 percent of procurement disbursement in 1980 to 1984 as compared to only 6.1 percent cumulative up through 1979.

While the MDB's have no control over the cost of the dollar or the developing countries greater competitiveness, and indeed they contributed to the countries greater competitiveness, certain practices of the banks and the U.S. Government can make a situation already difficult for U.S. companies more difficult.

The World Bank's recent emphasis on cofinancing has exacerbated the competitive disadvantage of U.S. companies. Companies find that foreign government aid in export credit agency projects have been very successful in pursuing cofinancing as a way of getting the foot in the door for their companies when it is biding time.

Most cofinancing with the United States is done through AID, which many companies do not feel has the same business promotion outlook that many foreign aid agencies do have.

In general, other countries governments are perceived to be more helpful to their companies than the U.S. Government is. This is a common complaint when you are outside of the Government.

However, some companies feel that U.S. Executive Directors who are appointed by the Treasury Department are more concerned with broad U.S. policy concerns than they are with business for U.S. companies.

One suggestion that companies have made that would give more effective support for U.S. business within the banks would be to establish a commerce department role within the office of the U.S. Executive Director.

Companies note that the switch of the Foreign Commercial Service from State to Commerce has had a positive result on promoting business abroad.

Another problem that U.S. companies see is the increased competitiveness of borrowing countries, as suppliers to MDB projects.

In World Bank bidding, for example, the local preference rule applies which builds a 15-percent preference into the bid of a local supplier. Since cost is the single most important factor in awarding

a bid it is virtually impossible for a U.S. company to beat a local supplier's price.

But some local suppliers are true industry heavyweights that don't need this competitive boost. One Brazilian contractor, Constructora Mendes, Jr., is a world class contractor and is a serious contender in the bidding on a huge World Bank project in Iraq. This same company would be granted the 15-percent preference on a project in Brazil though it competes quite successfully in the world market with no price advantage.

Apparently, the only way a U.S. company can get around that rule is to have a developing country partner, and this is presenting problems for many companies.

Perhaps the biggest impediment to greater involvement by U.S. companies in MDB projects is awarding the projects on low-bid basis as opposed to an evaluation basis. Currently many are awarded out of price consideration—don't take into account factors such as technological edge, quality, service, spare parts supply, operating costs, life cycles, and so forth. In the end, it is the low bid that tends to prevail in the system. MDB's are trying to cope with this problem, but with some mixed success.

The World Bank has been more effective in promoting evaluation systems than has the IDB according to our member companies. They all state, however, that while a third of the architecture and engineering contracts from the World Bank goes to U.S. companies, U.S. firms get less than 10 percent of the larger equipment contracts. A bidding system that might place emphasis on factors other than price could increase U.S. companies' competitive edge in this area.

At the same time, some companies do observe that getting the engineering and consulting project does allow a company a foot in the door.

In conclusion, Mr. Chairman, I would say that these are very hard times for both Latin America and for U.S. companies doing business there. The MDB's contribution to infrastructure and agricultural development in the region has been very important and incredibly important to U.S. companies.

They would have lost many millions, even billions of dollars of business in the region were it not for those development projects funded by the MDB's.

Thank you, Mr. Chairman.

[The prepared statement of the Council of the Americas as presented by Dr. Hayes follows:]

COUNCIL OF THE AMERICAS

AN AFFILIATE OF THE AMERICAS SOCIETY, INC. 1625 "K" ST. NW SUITE 1200 WASHINGTON DC 20006 202-659-1547

U.S. PRIVATE SECTOR BENEFITS FROM PROJECTS OF MULTILATERAL LENDING INSTITUTIONS

presented by:

Dr. Margaret Daly Hayes
Director, Washington Office
Council of the Americas

before the

Subcommittee on International Development Institutions and Finance
Committee on Banking, Finance and Urban Affairs
U.S. House of Representatives

July 16, 1985

COUNCIL OF THE AMERICAS
U.S. PRIVATE SECTOR BENEFITS FROM PROJECTS OF MULTILATERAL LENDING INSTITUTIONS

Testimony before the Subcommittee on International Development Institutions and Finance, Committee on Banking, Finance and Urban Affairs
U.S. House of Representatives
July 16, 1985

Mr. Chairman, Members of the Subcommittee, the Council of the Americas appreciates the opportunity to testify before the Subcommittee on International Development Institution and Finance of the Committee on Banking, Finance and Urban Affairs of the House of Representatives. The subject that you are reviewing today, the impact of multilateral development bank programs on the private sector, is an issue that is obviously of great interest to the Members of the Council.

I am Dr. Margaret Daly Hayes and I am Director of the Washington Office of the Council of the Americas. The Council is an association of U.S. Corporations with interest and investment in Latin America and the Caribbean. The Council's membership includes corporations in mining and manufacturing and services. Most of the major money center banks, most of our major U.S. accounting firms, and a good number of consulting and law firms are Council members. Together, the Council membership represents a very large proportion of total U.S. direct foreign investment in the region. The key interest that brings these firms together is their involvement in Latin America and the Caribbean. In preparing this testimony the Council's Washington staff* have

*Ms. Nellis Kincaid Crigler, Assistant Director of the Washington Office of the Council of the Americas, conducted the research on which this testimony is based.

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surveyed a number of our corporate members, asking them "how is important multilateral development bank financing to their operations in Latin America and what could be done to improve opportunities for U.S. business in the region?" For the most part, this testimony is a resume of these responses of the U.S. corporate community.

Before reviewing corporate views of the payoffs of MDB project financing, let me briefly describe the economic environment in Latin America as it affects U.S. corporations.

Background: U.S. Corporations and the Current Economic Situation in Latin America

U.S. Corporations are experiencing severe difficulties in Latin America. The chief cause of these problems is the prolonged recession that Latin America has been experiencing since the late 1970's and most sharply since 1982. Between 1980 and 1983 per capita income fell by over 9 percent in real terms. Gross Domestic Product (GDP) in Latin America fell dramatically in 1982 and 1983 and per capita levels of income have fallen most sharply because population growth has not stopped while economic growth has. In short, Latin America has lost a decade of growth and growth momentum.

U.S. firms participated actively in Latin Americas growth. In 1966 the United States was the locus of 18.8 percent of direct private foreign investment in Latin America. The region was the most active developing world recipient of U.S. direct foreign investment, and remained so until 1984 when it was replaced,

perhaps only temporarily, by Asia. The U.S. market share in Latin America did decline during the late 1960's and 1970's because of greater competition from European and Asian countries. In some sectors and in some countries companies have even complained of bias against U.S. firms as Latin American countries sought to diversify their economic relations. Corporations committed to the region regard such "bias" as part of the risk that is taken to do business abroad. It must be managed. Most U.S. corporations made their investment commitments in Latin America with an eye to a very long stay. Most are still there, despite problems and most intend to remain.

The current economic situation in Latin America is making it very difficult for companies to remain invested in the region. In 1984, the Council of the America's surveyed its membership to understand more clearly the impact on them of the debt crisis. The survey showed that while the U.S. companies worldwide sales declined in 1981 and 1982, they began to rise slowly again in 1984. Sales by local Latin American affiliates of U.S. firms (that is, associates of U.S. firms operating in Latin America) fell from $28 billion in 1981 to $21.5 billion in 1983, and were expected to fall to the $16 billion range by the end of 1984. Sales into Latin America also fell, by one-third from $3.6 billion to $2.4 billion in the same period. Latin America's share of U.S. corporate worldwide sales fell from 7.5 percent in 1985 to less than 5 percent in 1983. Latin American sales were expected to fall to about $16 billion in 1984.

This decline is especially worrisome, corporate insiders warn, because when an operation (i.e. Latin America) falls below 5 percent of corporate world-

wide operations, it begins to lose the interest of corporate management. New funds, key management resources, are simply not made available. Thus, the declining level of U.S. corporate involvement in Latin America may have long-term implications for the return of investment dollars to the region and for the region's own economic recovery.

In the Council's survey, "recessive local market conditions" and "generally poor (economic) outlook" were the chief reasons for company cutbacks or closedowns in the four major countries studied. Unlike local national companies which borrowed heavily in their local markets, few local affiliates of MNC's have a debt burden. Nevertheless, because of the loss of their local markets due to the deep recession, most have had to have recourse to parent company self-financing of some sort or another. Such self-financing has permitted the company to continue production and maintain staff with minimal lay offs. The Council survey suggests that after four years of such self-financing, willingness to commit further funds to Latin American affiliates has reached a limit. This was reported quite graphically by one corporate member operating in Peru who observed that his instructions from headquarters were to consolidate operations as necessary; to show a profit and not to expect any help from headquarters!

Let me add at this point that the Council's survey covered 158 affiliate operations in the four largest economies of the region, Mexico, Brazil, Argentina and Venezuela. The situation in those countries is not all bleak.

The survey noted the Mexican upturn in 1984 and predicted Brazil's dramatic recovery in the last half of 1984. However, the outlook in other countries of Latin America, --the Andean countries, Chile, Paraguay and Uruguay, and in Central America and the Caribbean Islands-- remains very bleak indeed. Recovery is a long way off, and sustained growth remains a dream. The only thing that will permit prospects to improve is renewed, sustainable growth in the region.

The prolonged recession in Latin America has a direct impact in the United States. The Commerce Department estimates that the downturn in Latin America has cost some 700,000 U.S. jobs. Companies that once enjoyed substantial markets in the region, particularly manufacturers of heavy construction equipment, were hard hit. J.I. Case Company's export sales to Latin America have declined 68 percent since 1980. In 1982, Deere and Company's overseas operations experienced a loss of $60 million after years of showing a profit. Caterpillar's sales to the region fell by more than two-thirds between 1980 and 1983, from $903 million to $266 million. Caterpillar classifies business in the region as "extremely depressed."

The MDB - Private Sector Connection

With commercial bank financing reduced to a trickle, and most of the countries in the region "graduated" from our diminishing pool of concessional assistance, financing provided through official sources, including the multilateral development banks, has become extremely important in Latin America. It is virtually the only source of financing currently available for continued development in the region.

When asked whether multilateral development bank funding helps U.S. companies to maintain sales in the region, the answer for most companies is an emphatic yes! This is true especially for Caterpillar, a company especially hard hit by the recession and ensuing austerity programs, which finds that the banks "are crucial" to their business in Latin America. Caterpillar expects this situation to remain for years to come. The Yacyreta hydroelectric project in Argentina and Paraguay, supported by World Bank and Inter-American Development Bank funds, has led to $25 million in sales for Caterpillar. Recently, Caterpillar won a contract in an Inter-American Development Bank project in Paraguay that will result in almost $2 million in sales. An MDB funded pipeline project in Colombia yielded several million dollars in sales. In Ecuador, a World Bank project to improve roads and infrastructure lead to the purchase of over a million dollars in Caterpillar equipment. The company feels that it has a good chance of becoming involved in an MBD funded project in Chile that could mean $3 million in sales. A spokesman for Caterpillar asserted that these projects would "definitely not happen" without financing from the multilateral development institutions. Since the debt crisis, MDB funded projects have grown as a percentage of Caterpillar's business in the region, demonstrating that for this company the multilateral banks are indeed stepping in where private sources of financing are no longer available.

The percentage of procurement from IDB and World Bank projects that goes to U.S. companies roughly parallels the U.S. share in those institutions. In the Inter-American Development Bank, the U.S. paid-in capital share is 34 per-

cent, and U.S. companies have received 15 percent of all contracts awarded by the IDB and 35 percent of all contracts awarded to non-borrowing countries. This was more than any other IDB member. In the World Bank, where the U.S. paid-in share is about 20 percent, U.S. companies have been awarded about 19 percent of contracts. Between 1980 and 1984, U.S. companies were awarded $376.5 million in contracts through the Inter-American Development Bank, and $4.2 billion through the World Bank and the International Development Association.

It is estimated that the United States gets $3 dollars back for every dollar contributed to all the multilateral lending agencies. For every dollar contributed to the Inter-American Development Bank, the U.S. gets a little over $2 dollars. In short, from the point of view of benefits to U.S. companies, contributions to the MDBs are a good investment.

Obstacles to Greater U.S. Shares of MDB Project Procurement

However, for a number of reasons, U.S. companies do miss out on important business opportunities available through the multilateral lending agencies, and the U.S. share of procurements, while still substantial, has declined. Until 1979, the U.S. share of World Bank procurement disbursements was over 25 percent. Between 1980 and 1984 procurement disbursements amounted to $3.5 billion but this represented only 9.7 percent of disbursements in non-borrowing countries. Between 1973 and 1976, U.S. companies won over 50 percent of contracts awarded through the Inter-American Development Bank. That

figure declined to only 22.4 percent between 1977 and 1980, but in 1981-1984 period the U.S. share of procurements rose again to 40 percent.

The biggest factor in the declining share of U.S. companies participation in development bank projects is the high cost of the dollar. Increased competition for contracts from developing countries themselves also contribute to a lower U.S. Share of the Pie. Developing country suppliers accounted for 14.9 percent of procurement disbursement in 1980-1984 as compared to a 6.1 percent up to 1979.

While the multilateral development banks have no control over either the cost of the dollar or developing countries' greater competitiveness, certain practices of the banks and of the U.S. government can make a situation already difficult for U.S. companies almost impossible. The World Bank's recent emphasis on co-financing has exacerbated the competitive disadvantage of U.S. companies. Companies praise the concept, which permits the Bank to leverage funding for large projects by involving other agencies. But they find that foreign government aid and export credit agencies have been very successful in pursuing co-financing as a way to get the foot in the door for their companies when the time comes to bid on contracts. Most co-financing with the United States is done through the Agency for International Development, which does not have the business promotion outlook of many foreign aid agencies. In fact, U.S. law directs A.I.D. to make "basic human needs" its first priority. As a result companies feel that the United States more often becomes involved in co-

financing projects with little business potential, while other countries actively seek out those projects that mean good business. World Bank projects with high business potential now require co-financing, meaning that U.S. companies are being crowded out of the best opportunities.

In general, other countries' governments are perceived to be more helpful to their companies than the U.S. government in pursuing business opportunities through the MDBs. Some companies feel that U.S. executive directors, appointed by the Treasury Department, are more interested in promoting broad U.S. policy concerns than business for U.S. companies. One suggestion for more effective support of U.S. business within the MDBs would be to establish a Commerce Department role within the office of the U.S. executive director. Companies say that the switch of the Foreign Commercial Service offices to Commerce from State resulted in a marked improvement in U.S. government responsiveness and effectiveness in promoting business abroad.

Companies believe that the U.S. government does not take the strong leadership role that it could within the MDBs to ensure that programs of potential benefit to U.S. companies and Latin America be carried out. One example is the proposed Inter-American Investment Corporation, which seems to be getting off to a slow start, even though it has a very successful precedent in the World Bank's International Financial Corporation.

Another problem for U.S. companies is the increased competitiveness of the borrowing countries themselves as suppliers for MDB sponsored projects.

Establishing world class industries in developing countries has been one of the major aims of the banks, and one of their greatest successes. In World Bank bidding, a local preference rule applies which builds a fifteen percent preference into the bid of a local supplier. Since cost is the single most important factor in awarding a bid, it is virtually impossible for a U.S. company to beat a local supplier's price. But some of these local suppliers are true industry heavyweights that don't need this competitive boost. For example, a Brazilian construction firm, Constructora Mendes Jr., is a world class contractor and a serious contender in the bidding on a huge World Bank project in Iraq. This same company would be awarded the fifteen percent preference on a project in Brazil even though it competes successfully in the world market with no price advantage. Currently, the only way a U.S. company can get around the local preference rule is to have a developing country partner. This presents problems for many companies. Since the Bhopal incident, U.S. companies have been particularly reluctant to relinquish control over operations when they could be held accountable for actions taken by the local management.

Perhaps the biggest impediment to greater involvement by U.S. companies in MDB projects is the practice of authorizing procurments on a low bid basis as opposed to an evaluation basis. Currently, many contracts are awarded purely out of price considerations and do not take into account factors such as technological edge, quality, service, spare parts, operating costs, and life cycle, all things in which U.S. companies excel. When procurement decisions are made on a cost basis alone, the borrowing country is often forced to obtain addi-

tional financing to replace poor equipment or obtain spare parts. In the end, the low bid system can cost both the borrowing country and the MDB more money than would a system that more carefully evaluates the savings inherent in quality, durable goods with long-term service support.

The MDSs are aware of this problem and have been trying to institute a bidding system based on evaluation, but with mixed success. The World Bank, according to U.S. companies, has been more effective in promoting the evaluation system than has the Inter-American Development Bank. U.S. companies are very successful in winning smaller, technical projects. A third of all architect/engineering contracts from the World Bank go to U.S. companies, while U.S. companies get less than ten percent of the larger equipment contracts, which involve a much greater amount of money. A bidding system that would place emphasis on factors other than price alone would increase U.S. companies' competitive edge.

Conclusion

These are hard times for Latin America and for U.S. companies doing business there. The contribution of the multilateral development banks to infrastructure and agricultural development in the region has been monumental. This development process has the overwhelming support of U.S. companies.

There are things that could be done to ensure that U.S. companies continue to benefit from multilateral development bank projects. But the biggest

benefit to all U.S. companies will be renewed economic growth in Latin America and the Caribbean. We hope that this will happen in a few years. In the meantime, the multilateral banks are playing an invaluable role in the region and merit continuing U.S. support.

The Following Companies are Corporate Members of Council of the Americas AND have been U.S. Suppliers Contractors on IDB-funded Projects 1961-1985

Alexander & Alexander Inc.
• Allis-Chalmers Corp.
American Can Company
American Cyanamid Company
American Express International Banking Corp (AMEREX, Houston)
The Anaconda Company
• Arthur Andersen & Co.
Armco Inc.
Bank of America
Bechtel Group, Inc.
Becton, Dickinson and Company
Brunswick International, Ltd.
Cargill, Incorporated
Castle Co.
• Caterpillar Americas Co.
The Chase Manhattan Bank, N.A.
Chemical Bank
• Chevron International Corporation
Combustion Engineering, Inc.
• Corning Glass
• Deere & Compnay
Diamond Shamrock Corporation
• Dow Chemical Latin America
E.I.du Pont de Nemours & Company
Eastern Air Lines Incorporated
Eastman Kodak Company
Eaton Corporation
• Ford Motor Company
General Cable International Inc.
• General Electric Company
General Mills, Inc.
General Motors Corporation
• Goodyear International Corporation
W.R. Grace & Co.
Gulf & Western Industries, Inc.
Honeywell, Inc.
Hughes Tool Company
• IBM World Trade Americas Corporation
Inco United States, Inc.
• Ingersoll-Rand Company
International Trading Co. (New Orleans)
ITT Corporation
Liquid Carbonic Corporation
Manufacturers Hanover Trust Compnay
McGraw-Hill, Inc.
Mobil Oil Corporation
• Monsanto Company
Morgan Guaranty Trust Compnay of New York
NCR Corporation
Olin Corporation
Owens-Illinois, Inc.
Pan American World Airways, Inc.
Peat, Marwick, Mitchell & Co.
PepsiCo, Inc.

Phelps Dodge International Corporation
Price Waterhouse
The Riggs National Bank of Washington, D.C.
Rockwell International Corporation
Scallop Corporation
Sears, Roebuck and Co.
The Singer Company
TRW Inc.
Teleconsultant Inc.
Texaco Inc.
Texas Instruments Incorporated
Union Carbide Pan American Inc.
Uniroyal Latin America
United Technologies Corporation
•Warner-Lambert International
•Westinghouse Electric Corporation
Xerox Corporation
Arthur Young & Company

• Contract awards in the last three years

Chairman LUNDINE. Thank you very much.
Mr. Liedholm.

STATEMENT OF CARL LIEDHOLM, PROFESSOR OF ECONOMICS, MICHIGAN STATE UNIVERSITY

Mr. LIEDHOLM. Mr. Chairman, it is a privilege to appear before this subcommittee this morning to comment on the private sector connection to development. I take your urging seriously that you wanted us to keep our remarks brief. That is rather difficult, particularly for college professors——

Chairman LUNDINE. Recognizing you are on a 45-minute clock.

Mr. LIEDHOLM. At Michigan State, it is even worse, it is 50 minutes. I apologize.

Chairman LUNDINE. You must understand Congressman are more juvenile than undergraduate students and we have a shorter attention span.

Mr. LIEDHOLM. I shall watch my clock carefully and try to effectively summarize my remarks, but I would respectfully request that the full written statement be included in the record with the exhibits.

Chairman LUNDINE. Thank you. It will be.

Mr. LIEDHOLM. I should like to focus my remarks primarily on the issue of what types of private sector activity should be fostered, giving particular attention to the size issue and the key role played by the small scale private enterprises in development.

The multilateral development banks, other donor agencies and many governments of the developing world have become increasingly aware in recent years of the important role that small scale private enterprises can play in providing productive employment and earning opportunities.

Yet, until recently, relatively little has been known about the small private firms in most developing countries, particularly those at the lower end of the size spectrum.

Most of these eluded the standard statistical net and exist unobserved in the underground economy. Consequently donors and Government policymakers, as well, charged with formulating policies and programs to foster these types of activities have frequently been forced, of necessity, to make such decisions in this area unencumbered by much information.

But fortunately several studies have recently been completed that begin to fill in some of the missing pieces in this small enterprise mosaic. Many of these studies were sponsored by AIDS-Bureau for Science and Technology which in the 1970's demonstrated remarkable prescience by sponsoring several detailed surveys to uncover, describe and analyze small scale industrial enterprises in a number of developing countries.

I should like to briefly summarize some of the findings of these studies and to discuss their policy and project implications for the multilateral development banks and other donor agencies as well as governments.

First of all, what are the most important characterization of these elusive small scale industrial enterprises in the developing countries?

First, small scale firms, which for purposes of this presentation refer to firms employing 50 workers or less, generally dominate the industrial sector of most of these countries, at least in terms of the number of establishments and the employment generated by them.

The data to support this statement as well as subsequent remarks I might make are found in the exhibits that are attached to the presentation.

Second, a surprising and yet important finding is that most of these industrial firms are located not—I underline the word "not"—in urban areas, but rather in rural areas at least in the lower income countries.

Three, the overwhelming majority of the firms are not just small, they are really very small, they are miniscule. Indeed, there are a plethora of one-person firms and indeed most of the firms in this small enterprise category employ fewer than five persons.

So in terms of their large numbers and relatively low income they constitute a potentially important target group for policymakers concerned with the lower end of the size spectrum.

Four, virtually all these small firms are privately owned and mainly organized as sole proprietorships. I might also add that significant numbers of the industrial enterprise entrepreneurs are female.

Five, small scale industrial activity appears to have been increasing in absolute terms in most developing countries. Although some segments of the small enterprise sector are declining, there are many more segments that are increasing so that onbalance the small scale sectors of these countries are growing rather than declining in importance.

What are the main sources of demand for the products of these small, tiny firms? The primary demand come from local incomes and consequently increases in the demand for their products are closely linked to increases in income, particularly among the rural and low income households in these countries.

The demands related to agricultural production both in terms of the demand for agriculture inputs and processing of agriculture output are also important; export markets for small enterprises are not generally important except for some particular productlines in some of the developing countries.

Another key question to ask, are these small enterprises efficient in their use of the country's scare resources? This is important as an issue, and there is quite a bit of rhetoric on this issue, but we are generally short of facts.

But most of the studies so far indicate that the small scale enterprises are, almost always, more labor intensive, generate more employment per unit of scarce capital, than their larger scale counterparts. And since capital is scarce in these countries and labor is, relatively speaking, abundant, these activities seem consistent perhaps with the factor endowments of these countries.

One might also ask, are these small firms more productive in their use of the scarce capital resources than their larger scale counterparts?

Again, the evidence in this is somewhat mixed yet I might add that a number of recent studies we did at Michigan State in collaboration with a number of local scholars indicates that in a large

number of activities where both small and large firms coexist that we find that they tend to generate more output per unit of capital than their larger scale counterparts, their capital productivity is higher.

Finally, there is a concept which we in the dismal science refer to as economic profits; it is not financial profit but the profit from society's point of view and where we price the inputs at their scarcity value; looking at this what do we find? At least in those industries we looked at in particular countries where both small and large coexisted, again, the small scale generated a higher rate of economic profit than the large.

So these findings, while certainly not conclusive, do indicate that at least in several lines of activities in several developing countries small scale private industries are economically efficient.

Well, in the light of the favorable characterization of these small enterprises, this combination of efficiency and equity all rolled up into one, what can governments, multilateral development banks do to further enhance the role of this lower end of the spectrum?

Two major avenues are available, one through seeking changes in general policy, which Mr. Carlucci mentioned, and others through direct project assistance.

In the area of general policy there are two particular things that could be looked at. The first of these is through attempting to institute a policy environment that is at least neutral with respect to enterprise size. It turns out that in most developing countries the general policies are biased against the small firms.

Frequently, these biases result from the unintended side effects of investment, trade, credit, and other policies that were implemented with the goal of promoting an expansion of the larger private enterprises.

The investment incentive laws frequently formally restrict the special tax concesssions to large firms and where these restrictions do not occur small firms are ignorant of the concessions available or unwilling to undertake the protracted bureaucratic procedures.

Trade policy is another area where frequently the large are favored over the small. The usual structure of import protection which involves high duty on luxury goods and low duties on intermediate and capital goods are frequently biased against small producers.

An example, admittedly anecdotal and episodic, may help illuminate this point. In Sierra Leone, large garment producers were covered by the Governent's industrial incentive and import substitutions tariff, and thus able to import their wonderful machines duty free.

The ubiquitous small-scale tailors by contrast found that the sewing machine, which is their big piece of capital equipment, was classified as a luxury consumer good and taxed accordingly. That is not a level playing field.

Credit policies also tend to discriminate against smaller firms; governments either implicitly or explicity have imposed the banking system interest rate ceilings of one sort or another that keep the interest rate from reaching a reasonably equilibrium level.

Faced with excess demands for funds the banks do what? They ration their scarce funds to their traditional large-scale clients.

As a result the small enterprises have been forced to obtain funds from family sources or from informal market where rates frequently exceed 100 percent. So, at least some efforts might be made here to remove the interest rate ceilings at least as a preliminary step to ensuring the interest rates for borrowers of all sizes more closely approximate the scarcity value of the capital.

In summary, on this first point, it is important to try to work then toward eliminating this existing policy bias against the small producer. This might be expressed in terms of the need simply to level the playing field so that policies are at least scale neutral. I am not arguing going beyond it to favor of the small but at least make it equal.

The second way for policies to be used to support small scale enterprise growth is through enhancing the demand for their products. One of the key constraints, particularly in rural areas, is limited demand for their products. The demand for low cost consumer goods and agriculture inputs sold in local markets is particularly high among small-scale farming households, policies that promote rapid increases in their agricultural income provide a powerful stimulus for the small scale private manufacturing enterprises.

Consequently, agriculture policies such as pricing and other measures aimed at increasing the incomes of the small farmers are important not only in their own right but because they can contribute effectively and in a major way to the growth of small-scale private manufacturing enterprises.

Mr. Chairman, this is an important point, as well for those of you who are on the Subcommittee on Hunger, because there are some important links between small-scale agricultural production and small scale manufacturing activities.

This point is also important because it demonstrates that in viewing the general policy environment for small firms, it is important to transcend traditional industrial policy to include other policies as well, foreign exchange, agriculture, and so on.

Projects have been the primary vehicle used by governments for fostering small enterprises. As Mr. Carlucci mentioned, small-scale enterprises are difficult targets to reach through direct project assistance; the firms are numerous, widely dispersed, and not easy to assist in a cost-effective manner.

Credit projects in particular have been the most commonly used method of providing direct assistance to small enterprises, and are a principle concern of your MDB's.

Although special credit programs have been designed specifically to reach the small- and medium-size firms in several developing countries, the smallest firms generally end up receiving very little of the funds. Moreover, the administrative costs of these programs have turned out often to be very high.

But several innovative credit schemes—again, Mr. Carlucci, the kind of new approaches that you urged be looked at—have been undertaken in several cases and appear to have been quite successful in providing financial resources to even the smallest of the private enterprises.

Some of these, again, have been undertaken by USAID. What are some of their common characteristics, and I will quickly review these as time is running short.

First, loans are provided primarily for working rather than fixed capital. Second, loans are screened in locally based institutions on the basis of borrower's character not necessarily just using collateral or project feasibility.

Third, loans are made for small amounts and for short periods to encourage and facilitate high repayment rates. You might note these are lending practices that are closely akin to those found in the informal credit institutions and it might appear that the nearer banks and formal institutions can come to their lending and screening and operating procedure the more likely they may be successful in making these kinds of loans.

I might even add that consideration might be given providing some technical assistance not to firms but to the financial institutions, Mr. Chairman, in order to enable them to develop more effective methods of lending to these small firms.

There are other direct assisted measures that are also used, such as delivering technical, marketing managerial skills and infrastructure inputs.

These are often criticized because the firms' demand for these inputs are sometimes very small, and large numbers of resources end up being concentrated on relatively limited numbers of clientele. A review of innovative programs has indicated that it may be possible to be successful in this area. I will not list their characteristics. They are in the text.

In short, Mr. Chairman, when considering the role of the private sector in development it is imperative that the small end of the enterprise size spectrum not be overlooked. The accumulated evidence, in fact, indicates that much of what is small is indeed beautiful.

With judicial government policies and more carefully designed measures, the already sizeable contribution of small scale components of the private sector to the economic growth of developing countries can be even further enhanced.

Thank you, Mr. Chairman, very much.

[The prepared statement of Mr. Liedholm follows:]

Hearings on the Private Sector Connection to Development

before the

Subcommittee on International Development Institutions and Finance

of the

Committee on Banking, Financing and Urban Affairs
U.S. House of Representatives

Prepared Statement
by

Dr. Carl Liedholm
Professor of Economics
Michigan State University

Washington, D.C.
July 16, 1985

It is a pleasure and privilege to appear this morning before the Sub-Committee on International Development Institutions and Finance to comment on The Private Sector Connection to Development. I should like to focus my remarks primarily on the issue of what types of private sector activities should be fostered, giving particular attention to the role played by small scale private enterprises in development.

International donor agencies and the governments of many developing countries have become increasingly aware in recent years of the important role that small scale private enterprises can play in providing productive employment and earnings opportunities. President Reagan's praise of the small scale entrepreneur in his recent St. John's University speech (March 29, 1985) and USAID Administrator McPherson's stress on the private enterprise "pillar" coupled with his recent statements on the importance of mobilizing an "LDC Entrepreneurial Revolution" indicate that such a focus is a paramount concern of U.S. policymakers as well.

Yet, until recently relatively little has been known about small private firms in most developing countries, particularly those at the lower end of the enterprise size spectrum. Most elude the standard statistical nets and exist unobserved in the underground economy. Consequently, government policymakers and donors charged with formulating policies and projects to foster small scale enterprises have frequently been forced, of necessity, to make decisions unencumbered by information.

Fortunately, several studies have recently been completed that begin to fill in some of the crucial missing pieces of the small enterprise mosaic. Many of these studies were sponsored by USAID's Bureau for Science

and Technology, which in the 1970's demonstrated remarkable prescience by initiating a series of surveys designed to uncover, describe, and analyze small scale industrial enterprises in several developing countries. Some of the key findings of these studies and their policy and project implications for governments and donor agencies will now be briefly examined.

Profile of Small Scale Private Industries

What are the most important characteristics of these elusive small scale industrial enterprises in developing countries? First, small scale firms, which for the purpose of this presentation are defined as those establishments with fewer than fifty workers, form a significant component of the industrial sectors of most developing countries. Not only are most of these establishments small, they also account for the vast bulk of industrial employment (see exhibit 1). They are generally engaged in the production of light consumer goods, primarily related to clothing, furniture, food and drink.

Second, a surprising, yet important finding is that in most developing countries, the vast majority of industrial firms are located in rural areas (i.e., all localities with less than 20,000 inhabitants). These are the private firms that are most frequently invisible. Employment in small rural manufacturing frequently exceeds that generated by all urban industrial firms (see exhibit 2).

Third, the overwhelming majority of the industrial firms are not just small, but are "very small." Indeed, there are a plethora of one person firms and most employ fewer than five persons. (exhibit 3). In terms of

their large numbers and relatively low incomes, they constitute a potentially important target group for policymakers concerned with the low end of the income distribution spectrum.

Fourth, virtually all these small firms are privately owned, mainly organized as sole proprietorships. In many countries, significant numbers of the small industrial entrepreneurs are female (exhibit 4).

Fifth, small scale industrial activity appears to have been increasing in absolute terms in most developing countries. Although systematic information on growth is limited, the available evidence indicates that it has even been growing at a faster rate than large scale industries in some countries. Since small scale industries account for such a large portion of total industrial employment, the absolute increase in employment absorbed by the small scale private sector is substantial in virtually all developing countries.

What are the primary sources of demand for the products of these small enterprises? The primary markets for small firms are local. Consequently, increases in demand for their products are closely linked to increases in income, particularly among rural and low income households. The demands related to agricultural production, both for agricultural inputs and in processing their outputs, are also important and are influenced by the country's agricultural strategy. Export markets for small producers generally play a relatively small role in most developing countries, although for some particular products they can loom large.

Are these small enterprises efficient users of these countries' scarce resources? Most studies indicate that small scale enterprises are

almost always more labor intensive (that is, they generate more employment per unit of capital) than their larger scale counterparts. Since capital and foreign exchange are relatively scarce and labor, particularly unskilled, is abundant, these small scale activities would seem to be most appropriate given most developing country's factor endowments.

A key related issue, however, is whether these same labor intensive small scale firms use the scarce factor, capital, more efficiently than their larger scale counterparts. The data needed to answer this question have generally been weak and the findings of the few existing studies, which usually compare output or value added per unit of capital, have yielded mixed results. New evidence on this issue, however, has recently emerged from a series of detailed industry studies conducted by Michigan State University in collaboration with local scholars in several developing countries. The preliminary findings from these studies, some of which are presented in exhibit 6, indicate that small firms in the specific industries examined consistently generate more output per unit of capital than do their larger scale counterparts.

An even better measure of economic efficiency is the "economic" profit generated per unit of capital, a measure that reflects profits when all inputs including family labor and capital are valued at their opportunity costs. Using this measure, a "marginal" firm would generate a zero rate of economic profit. The findings from the Michigan State studies (exhibit 6) again reveal that the small firms' "economic" profit per unit of capital not only are positive, but are consistently higher than those generated by the larger firms in these industries. These findings, while not

conclusive, do indicate that at least in several lines of activity in many developing countries small scale private industries are economically efficient.

Policy and Project Implications

In light of the many favorable characteristics of small scale portions of the private enterprise spectrum and the potential contribution these enterprises can make to the future growth in income and employment in developing countries, what can governments and donor agencies do to further enhance the role of small scale enterprises?

Two major avenues are available. The first is through seeking changes in the general policy environment that broadly affects small private enterprises, while the second is through the implementation of specific projects designed to provide direct assistance to individual firms. Each of these will be examined in turn.

There are two major ways that the general policy environment can be more supportive of small scale private enterprise in developing countries. The first is through instituting a policy environment that is at least "neutral" with respect to enterprise size. In most developing countries, however, general policies are biased <u>against</u> the smaller firms. Frequently, these biases result from the unintended side effects of investment, trade, credit and other policies that were implemented with the goal of promoting an expansion of large scale, private enterprises. Investment incentive laws frequently formally restrict the special tax concessions to large scale firms, or where such overt restrictions do not occur, small firms are ignorant of the concessions available or are unable

to undertake the protracted bureaucratic procedures required to obtain them.

Trade policies also tend to favor large over small scale enterprises. Foreign trade regimes using rationing systems for imports, coupled with overvaluation of the exchange rate, tend to discriminate against smaller firms since the larger firms are better placed politically and economically to receive the rationed import permits, foreign exchange, and tariff rebates. Even when direct controls are not imposed, the usual structure of import protection, which involves high duties on luxury consumer goods and very low duties on intermediate and capital goods, are frequently biased against small producers. An example should help illuminate this point. In Sierra Leone, large garment producers were covered by the government's industrial incentive and import substitution tariff policies and thus were able to import their machines duty-free; the ubiquitous, small scale tailors, by contrast, found that the sewing machine, their basic capital input, was classified as a luxury consumer good and was taxed accordingly.

The credit policies of most developing countries also have tended to discriminate against the smaller private firms. Governments either explicitly or implicity have imposed on the banking system interest rate ceilings or credit controls that have tended to keep the interest rate artificially low. Faced with excess demand for funds, the banks have generally responded by rationing the scarce funds to their traditional, large scale clients. Consequently, small enterprises have been forced to obtain funds either from family or from the "informal" market, where rates frequently exceed 100% per year. Efforts should be made to remove the

interest rate ceilings as a step towards ensuring that interest rates for borrowers of all sizes more closely approximate the opportunity cost of capital.

In summary, the most important first step in instituting a policy regime supportive of small enterprise growth is to eliminate the existing policy biases against the small private producer. This might be expressed in terms of the need to "level the playing field" so that policies are at least size "neutral"

The second major way that general policies can effectively be used to support small scale private enterprise growth is through enhancing the demand for their products. Most studies have made clear that one of the key constraints facing small enterprises, particularly those located in rural areas, is the limited demand for their products. Since a significant share of the low-cost consumer goods sold in rural markets is produced by small firms in that same area and the demand for these products as well as agricultural inputs is particularly high among the small scale farming households, policies that promote rapid increases in agricultural income provide a powerful stimulus for small scale enterprises. Consequently, agricultural policies such as pricing and other measures aimed at increasing the income of small farmers are important not only in their own right, but also because they can contribute in a major way to the growth of small scale private manufacturing activities. This result also demonstrates that in reviewing the general policy environment for small firms, it is of crucial importance to transcend the traditional sphere of

industrial policy and include agricultural, trade, foreign exchange and other policies as well.

Projects rather than policy reforms, however, have been the primary vehicle used by governments and international donor agencies for fostering small enterprise. Small enterprises, however, are difficult targets to reach through direct project assistance. The firms are numerous, widely dispersed and not easy to assist in a cost-effective manner. Indeed, virtually all small enterprise surveys reveal that only a tiny fraction of the entrepreneurs have heard of the programs intended for them and even fewer have been aided by them. Moreover, these same studies have indicated that the constraints facing these small enterprises and thus the types of direct assistance needed vary from industry to industry and from country to country.

Credit projects have been the most commonly used method of providing direct assistance to small enterprises and are the principal concern of multilateral development banks. Although special credit programs have been designed specifically to reach the small and medium sized firms in several developing countries, the smallest firms generally end up receiving very little of the funds. Moreover, the administrative costs have generally turned out to be quite high.

Several innovative credit schemes, however, appear to have been quite successful in providing financial resources to even the smallest private enterprises (see exhibit 6). What are their common characteristics? First, loans are provided primarily for working capital rather than for the fixed capital that has been the focus of most lending schemes. Second,

loans are screened in locally-based institutions on the basis of the borrower's character. Third, loans are initially made for small amounts and for short periods to encourage and facilitate high repayment rates. Since these lending practices are closely akin to those of the informal credit institutions, it would appear that the nearer banks and other formal institutions can come to the operating procedures of the informal lender, the more likely they are going to be successful in making loans to small private enterprises. Consideration might even be given to providing technical assistance to financial institutions in order to enable them to develop more effective methods of lending to small firms.

Nonfinancial direct assistance to small enterprises involves the delivery of such things as technical, managerial, marketing and infrastructure inputs. It is frequently argued that the small firm's demand for such services is generally quite small and that a large volume of resources end up being concentrated on a relatively limited clientele.

A review of a number of nonfinancial assistance projects, however, reveals that several common characteristics are associated with successful interventions. First, the projects are industry and task specific. Second, the projects address situations where a single "constraint" needs to be overcome by the firm rather than any array of such constraints. An implication of this finding is that projects assisting existing firms are more likely to be successful than those attempting to establish new firms. Third, before the successful projects or schemes are launched, prior surveys of the industry were undertaken to uncover the demand for the activity and the number and type of "constraints." Finally, successful

projects tend to be built on proven existing institutions, even "informal" ones.

When considering the role of the private sector in development, it is imperative that the small end of the [redacted] enterprise spectrum not be overlooked. The accumulating evidence, in fact, indicates that small is indeed beautiful. With judicious government policies and more carefully formulated direct assistance measures, the already sizeable contribution of the small scale component of the private sector to the economic growth of developing countries can be even further enhanced.

Exhibit 1

Table 1

Distribution of Employment in Manufacturing by Firm Size -- Percentage

Country and date	Per capita Income ($) 1982	Firm Size (number of workers) Large Scale 50 or more engaged	10-49 engaged	Small Scale below 10 engaged
India-1971	$260	38%	20%	42%
Tanzania-1967	$280	37%	7%	56%[a]
Ghana-1970	$360	15%	1%	84%[a]
Kenya-1969	$390	41%	10%	49%[a]
Sierra Leone-1974	$390	5%	5%	90%
Indonesia-1977	$580	16%	7%	77%
Honduras-1979	$660	24%	8%	68%
Thailand-1978	$790	31%	11%	58%[a]
Philippines-1974	$820	29%	5%	66%
Nigeria-1972	$860	15%	26%	59%[a]
Jamaica-1978	$1330	49%	16%	35%
Colombia-1973	$1460	35%	13%	52%
Korea-1975	$1910	53%	7%	40%

Note: [a] Computed as a residual, which is the difference between employment recorded in labor force or population surveys (includes all sources) and establishment surveys.

Sources: Africa: computed from Page (1979) and Liedholm and Chuta;
India: Mazumdar (1980);
Indonesia: computed from Snodgrass (1979);
Honduras: Stallmann (1985);
Thailand: World Bank (1983);
Philippines: Anderson and Khambata (1981);
Jamaica: Fisseha (1982);
Colombia: Berry and Pinell-Siles (1979);
Korea: Ho (1980).

Source: Carl Liedholm and Donald Mead, "Small Scale Enterprises in Developing Countries: A Review of the State of the Art," MSU International Development Papers, East Lansing, Michigan (forthcoming).

Exhibit 2

Table 5

Percentage of Manufacturing (Large and Small Scale) Employment In "Rural Areas"

Sierra Leone[a] -- 1976	86
Indonesia[b] -- 1976	80
Sri Lanka[c] --1971	75
Jamaica[a] -- 1980	74
Bangladesh[d] -- 1974	68
Philippines[e] -- 1976	61
India[a] -- 1967	57
Pakistan[f] -- 1975	52
Taiwan[g] -- 1976	49
Malaysia[a] -- 1970	46
Korea[f] -- 1975	30

Note: rural defined as all localities under 20,000 inhabitants.

Sources: [a] Chuta and Liedholm (1979)

[b] Snodgrass (1979), p. 32

[c] Sethuraman (1978), p. 62

[d] BIDS (1981), p. 63

[e] Anderson and Khambata (1981), p. 92

[f] Amjad (1984), p. 18; rural defined as localities under 5000 inhabitants

[g] Ho (1980), p. 21

Source: Carl Liedholm and Donald Mead, "Small Scale Enterprises in Developing Countries: A Review of the State of the Art," MSU International Development Papers, East Lansing, Michigan (forthcoming).

Table 6

Distribution of Small Scale Manufacturing Establishments by Size

-- Percentage --

Size (Number of Persons)	Bangladesh	India		Sierra Leone	Indonesia	Honduras	Egypt	Jamaica
	11 Thanas	Punjab Rural	Haryana Rural	All	All	3 Rural Provinces	2 Rural Governorates	All
	1980	1971	1971	1976	1974	1980	1982	1979
1	15	65	52	42	66	60	63	62
2 - 5	69	32	38	53	30	35	34	32
6 - 9	12	2	2	4	2	4	2	4
10 - 50	4	1	3	1	2	1	11	2

Source: MSU Country Studies plus:

India: computed from Gupta (1984, p. 79); includes "households" plus "establishments"

Indonesia: computed from Snodgrass (1979, pp. 13 and 23); intermediate categories are 2-4 and 5-9

Source: Carl Liedholm and Donald Mead, "Small Scale Enterprises in Developing Countries: A Review of the State of the Art," MSU International Development Papers, East Lansing, Michigan (forthcoming).

Table 7: Ownership of Small Scale Manufacturing Enterprises

-- Percentages --

Country		Public	Sole Proprietorship	Partnership	Corporation	Cooperative	Total All	Female Ownership
Africa:	Nigeria [three states]	---	98	1.4	0.2	0.4	100	NA
	Egypt [two governorates]	0.1	99.7	---	---	0.1	100	43
Asia:	Bangladesh [11 Thanas]	---	98.7	1.0	0.2	0.1	100	3.3
	Thailand [rural towns]	---	80.4	16.2	3.4	---	100	37
Latin America:	Honduras [rural provinces]	---	98.7	1.2	0.1	0.3	100	61
	Jamaica [entire country]	---	94.3	4.0	0.7	0.8	100	49

Source: Nigeria: Aluko et al., 1972 and 1973; Egypt: Davies et al., 1984; Bangladesh: BIDS, 1981; Thailand: Naronchi et al., 1983; Honduras: MSU country study, 1980; Jamaica: Fisseha and Davies, 1981.

Source: Carl Liedholm and Donald Mead, "Small Scale Enterprises in Developing Countries: A Review of the State of the Art," MSU International Development Papers, East Lansing, Michigan (forthcoming).

Exhibit 4

Liedholm

Exhibit 5

Table 13

Capital Productivity and Economic Profits -- Large and Small Scale Enterprises in Africa and Latin America

Country/Enterprise Type	Value Added / Capital Services: Large Scale[1]	Value Added / Capital Services: Small Scale[2]	Economic Profit[3] / Capital Stock: Large Scale	Economic Profit[3] / Capital Stock: Small Scale
Sierra Leone (1974)				
Clothing	1.7	8.3	-27%	+59%
Bread	1.7	12.4	-11%	+12%
Rice Milling	1.4	57.1	-30%	+80%
Botswana (1982)				
Sorghum Beer	6.2	19.6	+130%	+190%
Egypt (1982)				
Clothing	2.6	8.5	+17%	+42%
Metal Products	1.5	18.5	-3%	+103%
Honduras (1980)				
Clothing	2.5	6.9	-21%	+45%
Furniture	1.9	13.9	-26%	+58%
Shoes	0.9	12.5	-22%	+102%
Leather Products	1.5	10.6	-21%	+79%
Metal Products	1.4	12.1	-24%	+23%
Jamaica (1979)				
Clothing	1.6	10.5	-11%	+86%
Furniture	2.3	13.1	-0.4%	+173%
Shoes	2.3	17.8	-6%	+247%
Metal Products	2.8	6.6	16.9%	+56%

Sources: **Honduras** - small scale: data collected during 1980 survey of 485 rural small scale industries conducted by CDI and MSU; large scale: computed from worksheets of 1975 Industrial Census of Honduras (firms included ranged in size from 50 to 500 employees; **Jamaica** - small scale: data collected during 1979 survey of 197 rural and urban firms conducted by MSU, SEDCO, and University of the West Indies; large scale: 1977 industrial survey conducted by NPA; **Botswana** - Steve Haggblade, "The Shabeen Queen," Ph.D. dissertation, MSU, 1983; **Egypt** - small scale: data collected during 1982 survey of 460 manufacturing enterprises in two governorates, Fayoum and Kalyubiya; large scale: GOFI Investment Approvals, 1976. **Sierra Leone** - C. Liedholm and E. Chuta, The Economics of Rural and Urban Small Scale Industries in Sierra Leone, African Rural Economy Paper #14, 1976.

Notes: [1]Large scale firms are those employing fifty or more workers. [2]Small scale firms are those employing less than fifty workers. [3]In making these calculations, the following have been subtracted from value added: a) capital services valued at shadow interest rate; b. labor costs, including inputs of family workers and proprietors valued at the competitive wage in that industry. A marginal firm or industry would posses economic profits of zero.

Source: Carl Liedholm and Donald Mead, "Small Scale Enterprises in Developing Countries: A Review of the State of the Art," MSU International Development Papers, East Lansing, Michigan (forthcoming).

Table 2: Administrative Costs of Small Enterprise Credit Schemes

Credit Organization	Country	Type	Administrative Cost per Loan	Average Loan Value	Administrative Cost ($ of loan)	Arrears ($ of loans outstanding)
		A. Credit Only				
Krishi[1]	Bangladesh	Government-owned Commercial Bank	$5.00	$126	4.0	10.5
Agrani[1]	Bangladesh	Government-owned Commercial Bank	$5.27	$101	5.2	4.3
BKK[2]	Indonesia	Government	$2.37	$44.43	5.3	6
Janata[1]	Bangladesh	Government-owned Commercial Bank	$6.60	$125	5.3	14.5
Rupali[1]	Bangladesh	Government-owned Commercial Bank	$7.33	$119	6.2	6.2
F.D.H./Peru[6]	Peru	Development Bank	$531	$5961	9.0	8
Banco de Pacifico[4]	Ecuador	Commercial Bank	$140	$1100	13.0	7.0
D.B. Mauritius[4]	Mauritius	Development Bank	$108	$830	13.0	NA
Uttara[1]	Bangladesh	Government-owned Commercial Bank (cooperative)	$31.27	$122	25.6	12.1
Bank Money Shops[3]	Philippines	Commercial Bank	$197	$687	28.0	NA
SEDCO	Jamaica	Development Bank	$843	$280	275.0	NA
		B. Credit and Technical Assistance				
DDF/Solidarity[6]	Dominican Republic	PVO	$242	$1267	19.1	33
IDH[6]	Honduras	PVO	$561	$1724	32.5	42
DDF/"Micro"	Dominican Republic	PVO	$739	$1680	44.0	42
UNO[7]	Brazil	PVO	$1700	$200	85.0	8
PfP/BF[6]	Burkina Faso	PVO	$1238	$670	185.0	23

Sources: [1]J. Brown (1983); the credit organizations listed (e.g., Krishi) are government-owned commercial banks; [2]S. Goldman and Boediono (1983); BKK is the Badan Kredit Kecamatan (the sub-district credit body) program in Central Java; [3]M. Farbman (1981); [4]V. Raghaven and T. Timberg (1982); [5]M. Wilson (1981); SEDCO is the Small Enterprise Development Corporation; [6]P. Kilby and J. D'Zumura (1984); F.D.H./Peru is the Rural Development Fund Program of the Industrial Bank of Peru; DDF/Solidarity is the Solidarity Group component of the Dominican Development Foundation. I.D.H. is the Institute for Honduran Development. PfP/BF is the Partnership for Productivity Project in Burkina Faso; [7]J. Tendler (1983); UNO is Northeast Union of Assistance to Small Business Project.

Source: Carl Liedholm, "Small Scale Enterprise Credit Schemes: Administrative Costs and the Role of Inventory Norms," MSU International Development Working Paper, East Lansing, Michigan, 1985.

Chairman LUNDINE. Thank you very much.
Mr. Setubal.

STATEMENT OF LAERTE SETUBAL FILHO, PRESIDENT, BRAZILIAN EXPORTERS ASSOCIATION

Mr. SETUBAL. Mr. Chairman, it is with a mixture of pride and anxiety that I have glady accepted your committee's invitation to address this perplexing subject.

It is indeed a unique privilege for me to be in this place. Only in the United States would a foreigner be invited to express his views to the legislative body on matters of such international dimension and importance.

As a businessman I am involved on a daily basis with the affairs of my company and with the export sector. You have asked for impressions from a broad perspective. At times we confuse familiarity with knowledge and information and insight. I am comfortable with my familiarity and information on the subject.

I leave to you and your committee to provide the knowledge and insight. For my part I simply offer my personal views in complete sincerity and candor which I shall do now and place myself at your disposal for your questions.

Is the administration's emphasis on the private sector in foreign policy initiatives appropriate? Yes; certainly. In Brazil, we have recently established a "New Republic" after presidential elections, ending 20 years of military rule and fully reestablishing democractic processes and institutions.

The Government of the New Republic is convinced that the private sector is the correct solution to the economic troubles that have gripped the nation.

My presence here today, in my capacity of private businessman, is testimony to that fact. It would have been unthinkable a year or two ago.

This emphasis on the private sector and democracy in Brazil has been clearly understood by the Reagan administration, which has helped our nation during recent, difficult moments. We hope and trust that the legislative branch will come to share this same impression of my country.

The administration and Congress adopted the approach of development through the private sector in the Caribbean Basin Initiative. This was a step in the right direction, but a timid one.

If similar initiatives are to have an impact in the debtor countries, such as Brazil, they must be on a larger scale, in recognition of the larger dimensions of the problem. In the case of Brazil, we are talking about almost half of the economic output of all Latin America.

I mention here one of the dilemmas of the private initiative approach, which is the importance of market forces. For clear political reasons, major export products of the CBI countries were considered too sensitive to be included in the package.

If exports are the free-market solution to the debt problem, such political interventions should not neutralize the forces of the marketplace. Debt management thus depends on the real economic ad-

vantages of the debtor nations. Brazil possesses many of these advantages.

It is clear, however, that market forces alone are not sufficient to prevail, in time, against the immediate pressures of the foreign debt.

Political conviction is also required. The risk we face together is that if we have not the political will to confront the problem, the enemies of democracy will confront it for us. They will convert our economic troubles into a political threat.

They will ask world public opinion why the banks lent so liberally to authoritarian regimes, and then withheld credit from new democratic governments. We must face a certain political reality. In the words of one American banker, it is not a "realpolitik" to expect 200 million Latin Americans to make continuing sacrifices—"to work from sunup to sundown" for the next decade, just to guarantee the profits of the lending banks.

Is there a role to be played by the multilateral development banks, such as World Bank, in doing more to foster private sector development? Yes. Let us look at the case of Brazil.

In geographic terms, it represents 35 percent of the South American continent, and is larger than the Continental United States. It has over 120,000,000 inhabitants. In Brazil, the statistics are often of gigantic proportion.

We have one out of every four trees in the world, one-fifth of the world's fresh water, and the largest and most diversified industrial installation in the Southern Hemisphere.

Economically, we are twice the size of Mexico, four times the size of Argentina, and perhaps 10 times the size of the CBI countries put together. We have an abundance of natural resources, ample renewable energy, capable labor and management, and access to certain technologies.

This grand scale has created, in the last 20 years, a desire and a pressure within Brazil for a rapid pace of development. Unfortunately, the investment resources locally available were insufficient to the task. The scarcity of capital in an otherwise capitalistic country led to multinational investments and to the creation of the large external debt.

Capital is still scarce in Brazil. The Brazilian "prime rate" is now around 32 percent in real terms, as compared with a real prime in the United States of around 6 percent. Many sectors, even though, can make profits at those rates because working capital is so productive there.

To secure the economic growth that is consistent with both order and progress, multilateral development banks should come in to fulfill the gaps in capital requirements. The need is especially urgent now for two reasons.

First, the Government of Brazil is absorbing the largest part of domestic savings in order to serve its own internal debt, which is about the same size as the foreign debt.

Second, the availability of capital from private sources depends heavily upon the confidence the institutions have in Brazil, and this confidence can be restored by rapid successes of short-term infusions of the right type and magnitude.

In this regard, appropriate targets would be agriculture, export financing, working capital for the production of industrial products, and the refinancing of the food stocks held by the Government. This, in my view, is the correct role for the multilateral development banking institutions.

I would just like to add that the actions of these institutions must be closely coordinated. For instance, recently the World Bank offered a credit of $150 million to Brazil for export financing, which the Central Bank was obliged to decline. The reason was that the IMF objectives for the nonexpansion of the local money supply did not permit the Government to monetize this inflow in cruzeiros.

This was a frustration; nevertheless, the loss was not so great, because Brazilian industrial exports eligible for this financing reached $15 billion in 1984.

Thus, we lost financing on only 1 percent of that which we managed to export. This illustrates my point that the level of assistance must be on a scale sufficient to have a perceivable impact.

Now some reflections of a private Brazilian businessman. You might say that Brazilians can be classified, for present purposes, into four categories. Those who contracted the debt, those who spend the money, those who talk about the debt, and those who struggle to pay it back.

As an exporter, I am in the last category. As a businessman, looking at Brazil as if it were a corporation that has limited access to world capital markets, I believe that Brazil can only fulfill its obligations by increasing its sales to the world.

Therein lies the rub. The cruzeiro is tied to the dollar, so that Brazil has become, like the United States, a victim of the strong dollar. Last year alone we lost 36 percent on average in terms of price competitiveness as against the European currencies.

Not only is it difficult to compete in Europe and in Asia, where the dollar is strong, but in any markets where Euorpeans and Asians are also active as our competitors.

Added to that, we have phased out our export subsidies, and have raised the capital costs to our exporters, so that we now pay among the highest interest rates in the world for exports.

And even while Brazil has been complying with these commitments, the Europeans have continued their subsidies on meat, sugar, dairy products, poultry, and other products that weight heavily in Brazil's export mix. This is an area in which the United States and Brazil are natural allies.

The only other principal market for us is, of course, the United States. Here we are confronted with an irony. The increase in the intensity of protectionist sentiment here has threatened Brazilian trade in areas where we are natural and legitimate suppliers to the United States.

For the last 3 years, over 40 percent of the manufactured exports of Brazil to the United States has been subject to restrictions under the trade laws. Since we agree that exports are the key to the payment of the debt, this protectionism threatens our mutual economic interests.

As an aside, I should mention that American firms are the largest exporters of manufactured products from Brazil. The United

States is Brazil's largest foreign investor, with over $12 billion invested there.

We have four American Chambers of Commerce in Brazil, the oldest of which is celebrating its 65th birthday. The Brazil-United States Business Council is in its 11th year, and American investment in Brazil is now over $10 billion.

Brazil is now doing its part. We have met our GATT commitment to abolish export subsidies and have reduced import tariffs. Imports from the United States last year have risen 16 percent. We simply seek to inform you of this progress and to ask you moderation with Brazil in the struggle to resolve the troublesome problems of the strong dollar and the trade deficit.

In Brazil, the United States has a strong and traditional ally, a large, continental market economy and a newly established democracy. The social and economic challenges to the New Republic are great.

However, we feel that they can be met with the understanding and collaboration of the multilateral development banking institutions and the Congress of the United States.

Thank you.

Chairman LUNDINE. Thank you very much, and before going to the questions I want to comment to you that the Legislative Branch shares the administration's commitment to private sector development in Brazil and other developing countries. It isn't very often that I am presumptuous enough to speak even for the House of Representatives much less both the Houses of the legislative branch, but I think that is enthusiastically shared.

Moreover, many of us in the Legislature look at Brazil as the fulcrum of our interests in Latin America rather than some more publicized interests in Central America.

I will give you equal time.

Mr. Bereuter.

Mr. BEREUTER. Thank you, Mr. Chairman.

I don't need equal time on that one, I agree.

Thank you, gentlemen, and lady for your testimony. We very much appreciate it.

Mr. Carlucci, I want to thank you for all the time you devoted to the Commission. I had some inkling of how much that was. It was substantial.

Mr. CARLUCCI. Thank you.

Mr. BEREUTER. I know in the recommendation of the Commission that you chaired, the Commission on Security and Economic Assistance, there is strong emphasis on the country approach to program development. I agree with that recommendation. I am wondering what kind of recommendation would you have to a subcommittee that has the responsibility for authorizing and overseeing the U.S. participation in the various MDB's, the World Bank and the three regional banks in light of that recommendation? Is there anything that you can see that we can do to foster that country approach through the MDB's?

Mr. CARLUCCI. That is a very good question, Mr. Bereuter. It is clearly more difficult to involve the MDB's in a country-by-country approach than it is to involve Public Law 480, or security assistance, or ESF.

On the other hand, if it makes sense programmatically we ought not be driven by process. The MDB's have long leadtimes and they relate more to our Treasury Department than to some of the other Departments. As you will recall one of the more controversial recommendations of the Commission was the creation of an entity, an FBI-like entity in the sense that it had semiautonomy, in the State Department, which would have control over the budgets of the various AID organizations, including MDB's.

Secretary Shultz did not accept that recommendation, but he did say that he shared the goals that were expressed through that recommendation, of increased coordination.

I would think that any steps the committee could take to encourage the Treasury Department and the State Department and AID to work together more closely on the planning cycles for the MDB's recognizing that these cycles are frequently longer than the AID planning cycles, would be helpful. Indeed, I would encourage a rather intensive effort along those lines.

Mr. BEREUTER. It is quite complicated by the fact that Treasury and State have very important and not always coordinated roles I guess.

Mr. CARLUCCI. Yes; as you recall that was one of the most contentious aspects of our deliberations and whether we would try to include the budgets of the MDB's in the organizational entity that we propose.

Mr. BEREUTER. Right.

Dr. Hayes, I was particularly interested in the comments you made on pages 8 and 9 of your testimony, which suggested that the move to cofinancing is really disadvantageous to American firms.

That is primarily because of the orientation of the Agency for International Development.

I think that needs to be highlighted just by commenting on it and I hope that provides highlighting of what I think is a very, very intriguing criticism.

Is there anything you would like to say beyond what is in the written testimony on that point?

Dr. HAYES. Well, I would like to add that the Agency for International Development is trying to beef up its liaison with the private sector and having received this set of comments from our own corporate members, I think it behooves us in the Council and others to try to work more closely in order to steer AID in a direction that facilitates private sector access on some of these projects.

I think that is sufficient.

Mr. BEREUTER. Sitting on the Foreign Affairs Committee, also, do you think some statutory change is needed in giving direction to AID?

Dr. HAYES. That is a very big question. I think that it is well-timed that another look at the mandate that AID has to concentrate on the basic human need emphasis ought to be made. The economics of the developing world, particularly countries in Latin America, have changed substantially since the congressional mandate was initially established and while I would be in agreement with Mr. Liedholm in emphasizing that the small scale private enterprise also needs its attention, I think that our AID funds should be focused in some additional different directions.

Mr. BEREUTER. Thank you.

I would like to visit with you further on that, perhaps privately, when you have some time.

Mr. Chairman, I would ask unanimous consent that my opening statement be made a part of the record, and I will cease and wait for round 2 to address a couple other questions.

Chairman LUNDINE. Yes; there being nobody here to object, I already asked approval of that, and both your statement and mine is in.

Mr. LEVIN. I object.

Chairman LUNDINE. Your objection is not timely and it is ruled out of order, Mr. Levin.

Mr. Levin.

Mr. LEVIN. I am sorry I missed the first two presentations, Mr. Chairman, as well as the opening statement.

Chairman LUNDINE. Oh, it was, I will tell you——

Mr. LEVIN. I will read them in the record.

Chairman LUNDINE. Thank you.

Mr. LEVIN. I am glad to participate because, in part because of the importance of the discussion, and I don't have a lot of questions but I just think that my colleague's comments, Mr. Bereuter's comments on Dr. Hayes' testimony underlines the need for us to look at some of the specifics.

Cofinancing, practices on local preferences, practices on bidding even though it is hard to know what other system can be used in addition to low bids—I was a little surprised that the MDB looks only at the dollar figure. Is that correct? The multilaterals only look at the bottom line, the bottom figure, the dollar figure?

I find that a little hard to believe that there is no reference to anything else.

Dr. HAYES. I am sure that they look at a number of factors in making an assessment but I think what the companies are saying, and again this is the companies perception more than an analysis of the contract evaluations and awards, their perception is that the so-called low bid or low ball bidder gets the contract.

I was asking Mr. Carlucci whether that wasn't also the case in the U.S. Government very often, and whether the results weren't often the same. I think he would probably agree. This is a dilemma any time one engages in contracting. But I think we should be aware of the consequences and perhaps seek to work more closely with the banks to build in a more analytical award evaluation process.

Mr. LEVIN. Mr. Chairman, I think it would be useful if we could at least informally survey the banks on the contract procedures and that would get the information. It is my impression that they would say that cost is a critical factor but not the only one.

I would be interested in checking their procedures against the perceptions of the banks and with the way that the dollar is today, I think that inquiry might be of greater importance than usual.

I think we might be able to do it informally.

Chairman LUNDINE. We will do that. I wanted to consult with the banks, I know the banks make it a practice of not testifying but I think they would answer a letter and we will do that on behalf of the subcommittee.

Mr. LEVIN. Thank you.

[In regard to the above colloquy the attached letter from Chairman Lundine dated September 30, 1985, regarding current information on guidelines for goods and services purchased for international development bank projects, specifically, the awarding of contracts was sent to the World Bank, Inter-American Development Bank, Asian Development Bank, and the African Development Bank. Attached are responses received from the World Bank and the African Development Bank. Four Pamphlets on the above subject were received by the subcommittee. Three of the documents from the African Development Bank referred to in their response entitled (1) "Rules of Procedures for Procurement under African Development Fund Loans (1980), (2) "Uses of Consultants by the African Development Fund and Its Borrowers" (1980), (3) "Uses of Consultants by the African Development Fund (1967), and the fourth document from the Asian Development Bank entitled "Handbook on Bid Evaluation" are all retained in the subcommittee file and available for inspection.

Responses from the World Bank and African Development Fund referred to above follow:]

STAN LUNDINE NEW YORK
CHAIRMAN

JOHN J. LAFALCE NEW YORK
MARY ROSE OAKAR OHIO
SANDER M. LEVIN MICHIGAN
ESTEBAN E. TORRES CALIFORNIA
WALTER E. FAUNTROY DISTRICT OF COLUMBIA
BRUCE A. MORRISON CONNECTICUT

U.S. HOUSE OF REPRESENTATIVES

SUBCOMMITTEE ON
INTERNATIONAL DEVELOPMENT INSTITUTIONS AND FINANCE
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
NINETY-NINTH CONGRESS
WASHINGTON, DC 20515

September 30, 1985

Mr. Hugh Foster
Acting U.S. Executive Director
The World Bank
1818 H Street, N.W.
Washington, D.C. 20433

Dear Mr. Foster:

The Subcommittee on International Development Institutions and Finance recently held a hearing on the importance of the private sector to the development process. During this hearing Members of the Subcommittee, in response to testimony, expressed a desire to learn more about the specifics of procurement guidelines for goods and services purchased for use in World Bank financed projects.

In particular, questions were raised as to what criteria are utilized in awarding a contract to the successful bidder on a Bank financed project. It was stated in testimony presented to the Subcommittee that the Multilateral Development Banks strongly encourage contract awards on a low bid basis rather than an evaluation basis. This implies that the lowest bidder usually is awarded the contract and other considerations such as quality, service, spare parts, operating costs and life cycle are minimized.

It would be of great assistance to the Subcommittee if you would provide me with current information on World Bank guidelines regarding contract awards. Has it been your experience that the Bank does not give enough emphasis to quality, service and other non-cost considerations? Any insights which you can provide regarding the Bank's practices relating to procurement will be appreciated and made a part of the permanent hearing record.

Thank you in advance for your assistance in this matter.

Sincerely,

Stan Lundine
Chairman

The World Bank
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION
Washington, D.C. 20433
U.S.A.

October 3, 1985

Dear Congressman Lundine:

Thank you for your letter of September 30 to Mr. Hugh W. Foster concerning the World Bank's guidelines for awarding contracts.

At the present time, Mr. Foster and his senior assistants are attending the Bank's Annual Meetings in Korea. As the information you requested is to be used for the permanent hearing record, I am holding your letter for Mr. Foster's return so that we can provide you with a complete and helpful response.

Sincerely yours,

Pat Hubbard
Staff Assistant

The Honorable
Stan Lundine
U.S. House of Representatives
Washington, D. C. 20515

BANQUE AFRICAINE DE DÉVELOPPEMENT
AFRICAN DEVELOPMENT BANK

ADRESSE TÉLÉGRAPHIQUE
AFDEV ABIDJAN
TÉLÉPHONE 32-07-11
TELEX 23717
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RÉFÉRENCE
DATE November 11, 1985

The Honorable Stan Lundine
Congressman for New York
Chairman - Subcommittee on International
Development Institutions & Finance Committee
on Banking, Finance and Urban Affairs
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

I appologize for not responding sooner to your letter of September 30, 1985 regarding procurement practices and procedures followed by the African Development Bank. I only recently (Oct. 4th) took up my duties as United States Executive Director here at the Bank. Prior to that I was the United States Alternate Director to the Asian Development Bank in Manila for three and a half years.

If I may, I will address your questions from the standpoint of both the African and Asian Banks because their policies regarding bid-evaluation are quite similar. Both the Asian and African Development Banks specifically call for contract awards to be made to the lowest evaluated bidder, which need not be the lowest offered price. Quoting from the attached document prepared by the Bank's Central Projects Office: "The evaluation of bids must be consistent with the terms and conditions set forth in the bidding documents. In addition to the bid price.., other factors such as the time of completion of construction or the efficiency and compatibility of the equipment, the availability of service and spare parts, and the reliability of construction methods proposed should be taken into consideration."

I think it is fair to say that if the tender documents are prepared in a manner which gives weight to "life-of-the-product" considerations such as allowable "down-time", the availability of servicing and spare-parts, energy-efficiency or raw-materials economy, then the quality-product U.S. supplier is not disdvantaged in the bidding process - indeed he is advantaged.

Therefore, one of the useful roles a U.S. Director to a Multilateral Development Bank can play is to assist in the education of project officers, project design consultants and executing agency staff regarding the specification of quality standards in the bidding documents themselves and in the monitoring of the evaluation of the bid awards to ensure that the appropriate quality factors are given the weighting called for in the tender specifications.

Seminars for Bank staff on "life-of-the product" evaluation have been organized by the office of the United States Director to the Asian Development Bank and I have every intention of facilitating such activity here.

Mr. Chairman, I think it is fair to say that there has been a growing awareness emerging in the developing countries of the importance of product reliability and sound maintenance to successful project completion. United States quality products can benefit under MDB financed projects from this awareness.

Let me close with a small anecdote. In February of 1983, I visited a hydroelectric dam site in Malaysia. The project was being constructed by a Korean construction company with a Japanese construction management team and the trucks and other earth-moving equipment were Caterpillar. When I asked the Japanese Project Manager why he was using Caterpillar equipment he said simply "Because we can't afford down-time". We must all help to get that message across.

Thank you for your interest in the African Development Bank.

Sicerely,

Donald R. Sherk
U.S. Executive Director

Attachment as stated:

AFRICAN DEVELOPMENT BANK — BANQUE AFRICAINE DE DEVELOPPEMENT

INTER-OFFICE MEMORANDUM

Date: 30/10/85

TO : Mr. Don SHERK
Executive Director

FROM : Mr. C KAHANGI
Director OCPU

Subject : Criteria used in the award of contract to the successful bidder on Bank financed project.

1. INTRODUCTION

1.1 We have carefully studied the request which has been made by Mr. STAN Lundine (Chairman of the Subcommittee on International Development Institutions and Finance).

2. BACKGROUND:

2.1 The Guidelines for procurement of goods and services within the framework of Bank Group financed projects and programmes have been based to a great extent on the following documents:

(i) Rules of Procedures for Procurement under African Development Fund Loans (1980).

(ii) Uses of consultants by the African Development Fund and Its' borrowers (1980).

(iii) Uses of Consultants by the African Development Bank and its Borrowers (1967).

2.2 The Guidelines for the African Development Bank are under review and are expected to be presented to the Board of Directors shortly. However, until the new Guidelines are approved by the Board, the above are valid for procurement on ADB Group financed projects. It is expected that after the approval of the ADB Guidelines a unique document will be adopted for the Bank Group as whole.

3. ADB PROCUREMENT POLICIES AND PROCEDURES

3.1 Three basic considerations guide Bank procurement:

(i) the need for economy and efficiency in the procurement of the goods and works involved;

(ii) the Bank's interest, as an international finance institution, in giving qualified firms in all its member countries, regional and non-regional, an equal opportunity to compete in providing the goods and works it finances; and

(iii) the Bank's interest, as a development institution, in encouraging the growth of local contractors and manufacturers in the borrowing country.

3.2 The Bank's involvement in the procurement process extends throughout the project cycle. Bank staff are heavily involved during project appraisal, when consideration is given to the nature of the goods and works to be financed and the most appropriate means of procurement, and to the capabilities of local contractors and manufacturers. The details of the proposed procurement methods for the project are discussed and agreed upon with the borrower during negotiations. During project implementation, the supervision of procurement again requires extensive effort of Bank staff and includes review of advertising procedures, prequalification lists, bidding documents, etc. to ensure their conformity with agreed procedures.

3.3 Since project implementation is the responsibility of the borrower, so is procurement. The borrower, with the help of consultants if necessary, plans and schedules the procurement, prepares the advertisement and bidding documents, evaluates the offers and makes the award. However, as part of the Bank's responsibility in ensuring that loan proceeds are suitably used, Bank staff supervise project execution to make certain that the procurement of the goods and works follows the procedures laid down in the loan agreement and that the borrower acts diligently, reasonably and fairly in its procurement decisions.

3.4 A major portion of Bank staff effort involves the review of draft bidding documents and evaluation reports of major contracts before award to ensure that they have been processed in accordance with agreed procurement procedures. If a contract award by a borrower is not in conformity with the agreed procedures, no disbursement is made.

3.5 Local manufacturers and contractors are encouraged to participate in international procurement. They may bid independently or in joint ventures with foreign firms. The Bank, however, does not approve conditions of bid invitation under ICB which would compel foreign firms to enter into joint ventures with local firms for the provision of goods and works.

3.6 Practice has shown that in most cases, the needs and interests indicated in para. 3.1 can best be realized through international competitive bidding, with appropriate allowance for preferences for local or regioanl manufacturers and local civil works contractors. However, there are circumstances in which ICB is not the most economic and efficient method of procurement and when foreign firms, i. e. firms not already established in the local marketplace, are not expected to be interested. In these cases, the Bank and the borrower agree upon such other appropriate arrangements as will assure the basic objective of economy and efficiency. These appropriate arrangements refer to other methods of procurement such as Local Competitive Bidding (LCB) Direct Purchase, Force Accounts etc.

4 RELEVANT SECTIONS OF PROPOSED ADB GUIDELINES

4.1 Some relevant sections of the proposed Guidelines, and their underlying philosophy, and are cited here below:

A. Objective

A.1 "The objective of these rules is to enable borrowers to acquire high quality goods and services at the most favourable rates compatible with the conditions which govern the Bank's loans as well as to enable contractors and suppliers to fully understand the requirements which have to be met so that procurement under Bank's loans can proceed expeditiously".

A.2 "The general principle underlying these rules, in the light of which they are to be interpreted and applied, is the intention of the Bank to provide the most efficient way of implementating projects with respect for fairness, equality of opportunity for prospective contractors and suppliers, as well as due consideration for economy and efficiency".

B. Basic Principles

B.1 "The Agreement requires that the proceeds of any loan be used with due attetion to considerations of economy and efficiency (Art. 17(h) of Agreement). Therefore, as a metter of policy, the Bank generally requires that there should be public bidding for the procurement of goods and services needed for the implementation of projects financed with loans from the Bank".

B.2 "Since the Bank normally finances only a part of the cost of projects and programmes it requires that in all cases a system of competitive public bidding be used in purchasing equipment, materials and supplies and in contracting for construction of works required to implement any of the projects or programmes partially financed with its loans. Furthermore, it requires that other bidding procedures and contract awards which may be used for procurement of goods and construction works for projects and programmes partially financed by the Bank should be subject to conditions acceptable to the Bank, consistent with its policies and the purpose of the loan that is being granted".

C. Award of Contract

C.1 " The award should be to the bidder whose bid has been determined to be the "lowest evaluated bid", which shall not necessarily be at the lowest offered price, and which meets the appropriate standards of capability and financial resources. Such bidder

should not be required, as a condition of award, to undertake responsibilities or work not stipulated in the specifications of the bid".

C.2 "The Bank shall approve the award and the successful bidder. If the Bank determines that the proposed award is not consistent with the terms of its loan agreement with the borrower, it will promptly inform the borrower of its determination and state the reasons thereof and the contract will not be eligible for financing by the Bank".

D. Evaluation and Comparison of Bids

D.1 "Bid evaluation has the purpose of determining the value to the borrower of each bid in a manner that will provide meaningful comparison among responsive bids and the determination of the lowest evaluated bid".

D.2 "The evaluation of bids must be consistent with the terms and conditions set forth in the bidding documents. In addition to the bid price, adjusted to correct arithmetical errors; other factors such as the time of completion of construction or the efficiency and compatibility of the equipment, the availability of service and spare parts, and the reliability of construction methods proposed should be taken into consideration. To the extent practicable, these factors should be expressed in monetary terms according to critaria specified in the bidding documents".

4.2 The preceding extracts from the proposed ADB Guidelines underline that one of the objectives is to "enable borrowers acquire high quality goods and services" (para. A.1). Therefore it can be affirmed that the Bank does give emphasis to quality. Further, under para. B.2 it is stated that other factors are taken into consideration in addition to the price in the

evaluation of bids. This is put in another way under para. C.1 where it states that the lowest evaluated bid is not necessarily the lowest offered price, but rather one which meets the appropriate standards of capability and financial resources.

5. SUMMARY AND CONCLUSION

5.1 In summary it can be concluded that the hypothesis which states that Multilateral Development Banks strongly encourage contract awards on a low bid basis rather than on an evaluation basis cannot be accepted as true. What is true is, that other factors are also taken into consideration in determining the "lowest evaluated bid".

Mr. LEVIN. Second, and I think we need very much our subcommittee, I know the chairman is interested in this, and I know the ranking member is interested in the whole issue of the role of the Commerce Department. I was in Japan a couple weeks ago and I was struck again, we have improved the situation with the movement of the commercial officers to the Commerce Department but they are grossly understaffed and the figures as to the contrast between the number of U.S. commercial officers helping American business in Japan and Japanese commercial officers helping Japanese businessmen in the United States was striking. You would think that we had a trade balance with Japan of $25 billion the way we were acting in that regard instead of the other way around.

So, I think we should pursue these suggestions and I am sure we will.

Let me just say one last thing, as kind of a comment and perhaps any of you may want to respond.

I have other specific questions, but let me address myself to the more general questions.

At the end, Mr. Carlucci, you say that it is important that we not let the current focus on the private sector degenerate into sterile ideological debate. I agree with that so much. I think that we have let debate over foreign aid descend into either/or propositions.

In a way, I think you have at least almost done the same by describing your contrast of the present with the past—I said "almost"—because you talk about in your testimony a dramatic reorientation in thinking. That is dramatic language right there.

It was interesting to read the testimony of Dr. Liedholm on page 1 where there is reference to crucial missing pieces of the small enterprise mosaic and a reference to studies in the 1970's in AID that demonstrated remarkable prescience by initiating a series of surveys designed to uncover, describe and analyze small-scale industrial enterprises in several developing countries.

That made me think, for example, of the Pacific rim countries and the agencies and our Government's involvement with them. The efforts go way back in South Korea of the United States fostering through the AID Program a private sector research and stimulus to that whole area. Also in India, the development of agricultural research entities with the help of the foundations, where I think half of them more or less succeeded and played a major role if not the key role, but a major role, in sparking essentially private sector agricultural development in India because there was very little collective, as you know, or even cooperative agricultural practice in India.

I just mention this to you because I think there has been some shift but every new administration wants to do it differently. That is certainly been true of AID. The reason I think it is a mistake to overstate it is because, first of all, I don't think it is accurate by definition; second, I think it somewhat undermines the effort to convince legislators among others to be supportive of foreign assistance.

When the administration, the Carter administration was guilty of somewhat the same, you know, I was part of it, wanted to do it differently so we set up different entities and so on, et cetera, et

cetera, but I think that discontinuity can hurt understanding on the Hill of what has been going on.

I think somebody does need to look carefully at the issue of whether indeed there has been a dramatic reorientation.

The same I might say with emphasis on policy, because that emphasis on policy didn't begin in 1981. It has been going on for a number of years before that. I think it is accelerated but perhaps because the world financial picture has very much changed.

So, for your comment or your criticism or whatever, I just throw that out because that is kind of the focus of our hearing today, the interplay between private and public sectors.

Mr. CARLUCCI. May I comment on that, Mr. Levin.

If I may be forgiven for drawing on personal experience, let me just cite the case of four countries in which I have served; Zaire, which has now turned around completely, is following the IMF rules and actively is seeking private sector capital. This is a rather dramatic change.

Tanzania, where they are talking about privatizing the government-owned sisal plantations.

Portugal, where you have a Socialist government that changed the laws and allowed private banks back in, is talking about additional measures to attract foreign capital as well as moves toward privatization.

Brazil, which, of course, Laerte Setubal is much better equipped to speak to than I, where they are talking about a measure of privatization as well.

I think this is a, I personally think it is a refreshing change but I would argue strongly that it is a change.

On the other hand, I did not mean to imply in my statement that the private sector was a be all and end all. Indeed, I think my statement says that the most crucial change, the most crucial boost the private sector may well be getting would be the policy changes stimulated by the World Bank efforts. Indeed, it is a basic responsibility of government to lay the groundwork for private sector activities. The two have to work in tandem.

I think you cited South Korea, and our Commission report did as well, as a very good example where you—in fact, maybe it is too good an example—where you get government stimulating the private sector often to the disadvantage of other country competitors. But in any event, in my judgment it does require a cooperative effort with both the private sector and government.

I do think, though, that our AID Program certainly in the years in which I was directly associated with it on the operating end, focused very much on improving the public sector. Today, there is much more talk about stimulating the private sector.

So, I would argue that this is a change, but it is a change within a spectrum of continuity if you will.

Mr. LEVIN. Yes.

Mr. LIEDHOLM. If I might briefly comment on that, Congressman Levin is here now, I would just like to say that for the record, Mr. Chairman, that Congressman Levin actually headed the Bureau for Science and Technology during the time in the 1970's when some of these private sector studies were undertaken, and indeed if I had a hat I could tip it to you here.

Mr. LEVIN. That is all right.

Mr. LIEDHOLM. I don't have a hat so I won't tip it, but the other thing I would just like to mention is something again Mr. Carlucci alluded to; I think it is important to specify what kind of public expenditures you are talking about. In a sense a lot of what we think of as public expenditures are really crucial elements and in some cases almost preconditions for effective private sector growth. Just a few examples. The human capital development, higher education, particularly in Africa for education relating to agriculture, technical agriculture and even business administration is important.

Another example is public expenditures on agriculture research for the agriculture experiment stations. This is related to the land grant philosophy in the United States. Again, the same notion applies. These are public expenditures but are really crucial elements for facilitating private sector growth.

Then there is the infrastructure element argument as well, such as the provision of a road. So, I think we have to get away from this simple private versus public dichotomy.

Chairman LUNDINE. It seems the gentleman from Michigan has been stimulating because we have another would-be commentator.

Dr. HAYES. I would like to add a comment on the situation, at least as it is seen in Latin America, and that is that for a very long time I think the development model that was prevalent in that region was one that emphasized the role of government in orchestrating and fulfilling the chapters and verses of a development plan. And it is only very recently, in the last several years I think, that there is an active discussion in the region of the role of the private sector and its efficiency and so forth.

I think Laerte Setubal could comment very well on the problems that a very sophisticated private sector in a very sophisticated country have had with a government that implements a more or less textbook plan.

In making that choice between private and public sector, I think one has to go with the flow and we are in a period of greater emphasis on private sector now that I believe was not there in the last couple of decades.

In Latin America, however, I think there is a very healthy movement with which the United States can play very actively.

Chairman LUNDINE. I would like to revisit one issue first that my colleagues touched on.

Dr. Hayes, the subcommittee has had previous testimony indicating that European and Japanese private banks actually use World Bank cofinancing programs more actively than U.S. banks. Would U.S. banks get more cofinancing if our private banks were to more closely work with the World Bank on cofinancing opportunities?

Dr. HAYES. I am not sure that I am able to answer that question as specifically as I would like to, and let me come back with a response for the record if I may.

[In response to the request of Chairman Lundine, the following information was submitted for the record by Dr. Hayes:]

COUNCIL OF THE AMERICAS

October 1, 1985

The Honorable Stan Lundine
Chairman, Subcommittee on International
Development Institutions and Finance
Committee on Banking, Finance and Urban Affairs
United States House of Representatives
Washington, D.C. 20515

Dear Congressman Lundine:

During hearings on the Private Sector Connection to Development last July 16, you asked me why the U.S. private banks seemed not to be taking advantage of co-financing facilities of the World Bank and the Inter-American Development Bank as European or Japanese banks seemed to be doing. This was a question which had to be answered by the banks themselves and I promised that I would survey some of our member banks and pursue an answer for you.

The answer or answers are summarized in the attached paragraphs. I hope the response is useful, and if I can provide any further answers to questions on this issue, I hope that your staff will be in touch be me.

Sincerely,

(Dr.) Margaret Daly Hayes
Director, Washington Office

QUESTION: Mrs. Hayes, the subcommittee has had previous testimony indicating that European and Japanese private banks actually use World Bank co-financing programs more actively than does the United States banks. Would U.S. get more co-financing if our private banks were to more closely work with the World Bank on co-financing opportunities?

RESPONSE: Council of the Americas Members who were questioned on this indicate that co-financing has not been attractive to U.S. banks, especially those already heavily exposed in Latin America. However, it is not the co-financing concept that is unattractive, but, rather, the overall economic situation in Latin America and the position of the Banks. In general banks are not making new credit of any kind available in Latin America. Many are at their limits of country exposure, and may not advance more funds. Since many of the Latin American countries are in line for new loans to enable them to keep up payments on existing debt, commercial banks are constantly being asked to ante-up new, unencumbered money to support those loans. Each bank is asked to put up an additional percent of its existing exposure to support the new loans. Thus, the bigger the bank's base, the greater the amount of new money it is asked to put up. This process repeatedly challenges the bank's country lending limit, and leaves little room for other types of projects, especially projects that might be of a longer term nature as are many of the co-financing projects.

The U.S. money center banks are in a different position than are the European and Japanese banks. Neither the Europeans nor the Japanese are exposed in Latin America on anything like the scale that U.S. banks are exposed. Regulations governing exposure and reserves are different in the other countries. Many of those banks are providing supplier credits. The suppliers work out a deal with the bank whereby the supplier prices his product to cover any potential loss to the bank. The U.S. doesn't do this. Large U.S. banks would be more inclined to engaged in co-financing if their lending were fully guaranteed as it is in Export--Import Bank or Commodity Credit Corporation guarantees. The World Bank "B-loan" strategem is still unfamiliar, and, in any case, tends to place the banks in a longer term posture than they are presently comfortable with. Over time, however, it is not impossible that the "B-loan" would be more attractive to some banks.

Regional banks in particular do not prefer the longer term projects that tend to characterize co-financing activities at present. Their forte is in trade and other short term financing, not in the longer term project financing. The regionals feel that they often do not have the staff to make the proper assessments of the quality of large scale projects and, while they respect the World Bank, they are reluctant to rely exclusively on World Bank assessments when engaging their money.

One banker suggested that the Latin Americans were not particularly eager to engage in co-financing arrangements because this entailed accepting World Bank conditionality. In the days of greater world liquidity, the Latin Americans became used to getting funds in the open market place without conditions. They are now chafing under IMF conditionality and are reluctant to encourage loan packages that entail additional conditions, in this case World Bank-administered conditions. This will continue to be a difficult point with the debtor countries.

In short, the co-financing arrangement appears to have a limited appeal for the majority of banks which prefer shorter term lending strategies and for some Latin American countries. However, even if co-financing were generally attractive, the already great exposure of the banks in Latin America would preclude many if not most U.S. banks from participating unless regulations governing exposure were changed substantially.

Chairman LUNDINE. Fine.

I would invite either Professor Liedholm or Mr. Setubal to comment.

If I want to learn about smaller enterprises and private entrepeneurship—one place among others to learn about what happens in the U.S. economy is to go to Florida. You can learn a lot around golf courses down there because those are the folks that made it, and you learn how they made it.

These people are not former employees of General Motors or General Electric. They are in general, folks that had a smaller enterprise and almost invariably sold it out. I mean that has gotten to be the American way of making it.

You start something, you build it up and you sell it out. I am not entirely pleased about that, but that seems to be how our private enterprise system is working.

My question is, in these developing countries, is there the same sell-out/buy-out opportunity as there is in the U.S. or other developed countries' economies.

Mr. SETUBAL. Well, not as far as Brazil is concerned, which is the only country which I have some experience because I was born there and my family has lived there for 400 years or something like that. I must know something.

No, there isn't. Actually the attitude of the Brazilian society toward the individual entrepreneur is to keep it in the family. There is a family possession toward what has been built up and they expect that this will continue.

Chairman LUNDINE. What happens if the sons or daughters are not interested in the business? What generally happens?

Mr. SETUBAL. Well, they would probably sell not to a large corporation because this is the difference, maybe, but I think for instance in the States as far as I know it is normal for a large corporation to buy the larger supplier or larger consumer. This is a vertical situation.

Chairman LUNDINE. Right.

Mr. SETUBAL. This is not unusual in Brazil. Actually companies normally expand on a horizontal way instead of vertical. It is based on the fact that you should on such an economy that is so flexible, fluctuating, if you stay on the same activity, commercial activity, you will be suffering all the way around, either with your customer or with the supplier.

So if you are to expand you choose another field so that you can balance, if you are in construction you go into whatever, minerals or timber or whatever.

So this is I think the main difference. The tendency is to keep the enterprise in the family. If it is not possible, you would then sell to someone that is a similar competitor or something like that.

Mr. LIEDHOLM. The evidence from what we have been able to put together from particularly Africa and some other parts of the developing world indicates that in some cases the small and particularly these very tiny, tiny, tiny firms do frequently then grow a little bit larger, up maybe to the small size but then—again it is an interesting research question that has not been really addressed, how many of these become essentially transformed into butterflies

and become the even larger enterprises, and then what happens at that stage?

At the moment it looks like while small enterprises provide some seedbed for the larger firms, most of the time what happens is it turns out that you get a small firm and it gets a little bit bigger and then when the entrepreneur dies usually that is transferred to somebody else in the family; or, essentially what happens is you get development by replication, a small tailor who gets a little bigger and trains an apprentice, and he goes out and sets up another firm about the same size so you get kind of a lateral development but not so much vertical development, and so most of this kind of activity stays in the family or extended family.

Chairman LUNDINE. One brief factual question, did you say that U.S. exports to Brazil rose last year?

Mr. SETUBAL. Yes, imports—sure, exports form this country.

Chairman LUNDINE. Increased? I am amazed at that.

Dr. HAYES. Brazil recovered in 1984 and Brazilian growth was, what, 4 or 5 percent.

Mr. SETUBAL. 4.5.

Mr. LEVIN. Exports to the U.S. increased proportionally.

Dr. HAYES. Substantially, yes.

Mr. SETUBAL. Sure. But exports to the States has grown $7 billion even though imports was greater.

Chairman LUNDINE. The net balance of trade is favorable to Brazil?

Mr. SETUBAL. The trade balance, yes, but the current account is unfavorable to Brazil.

Chairman LUNDINE. Right, right. We understand that.

Mr. SETUBAL. We are glad to help.

Chairman LUNDINE. It is somewhat of a mutual problem, believe it or not.

I would like to ask if any of you have a comment. One of the most intriguing possibilities and concrete recommendations that has been made in this series of hearings was actually made at the first one. A witness stated that he thought that the IMF tends to come into the debt-ridden countries and impose sometimes very difficult discipline and take a very short-term point of view and that on the other hand, the MDB's come in and they take a 30-year to 50-year point of view and there is not much coordination.

The frustration in a country—he used Brazil as an example, I think—is that not only are they asked to put up with austerity but there is not much coordination by any of these experts at the MDB's and IMF, as to how the country works itself through that intermediate term.

His suggestion was that we offer the suggestion to the World Bank, for example, to work out a joint program with the Fund on a one-country demonstration basis.

What do you think of the idea? Is it too much planning? Are we incapable of that type of coordination or would it be worth a try?

Mr. CARLUCCI. I think it is a good idea. Our report came fairly close to that in encouraging the World Bank to take a coordinating role among donor countries.

Prior to our submitting the report, we held a series of informal sessions with some people from recipient countries, particularly Af-

rican countries, and the confusion that existed was absolutely unbelievable. The differences they describe between the AID programs, the bilateral AID Programs, multilateral AID Programs, the IMF, the World Bank were enormous. U.S. programs, by the way, were among the more bureaucratic, according to the people we talked to.

They threw up their hands and they said there is no way we can do sensible planning in our countries because one donor requires this, another one requires that, and on top of it all you get the IMF coming in.

I think the World Bank should take the lead in coordinating all this assistance and in establishing a relationship with the IMF so that short-term and long-term policies are in harmonization. I think it is a very good suggestion.

Dr. HAYES. I would also say I think it is a very good suggestion fraught with a lot of bureaucratic difficulties. For instance, the IMF would find it difficult to make an exception to public as opposed to private exceptions they make all the time, to its austerity programs in this particular period because then of course everyone else would want to be on the bandwagon and one could have something of a Pandora's Box but certainly there has to be considerably more collaboration and understanding of the mid-term and long-term implications as opposed to only the short-term goals in these efforts.

Chairman LUNDINE. Mr. Carlucci, I am interested in your analysis of how significant the World Bank's proposal for a multilateral investment guarantee agency wil be in stimulating private investment in developing countries.

Mr. CARLUCCI. I think it will be helpful. Insuring against political risk and currency risk is a fundamental need. MIGA could do that. Obviouisly we in this country can draw on OPIC, but this would put it on a worldwide basis. To have a worldwide kind of OPIC would clearly stimulate investment movement.

So I would thoroughly endorse it.

Chairman LUNDINE. I have further questions but I don't want to monopolize the time.

Mr. BEREUTER. After you, whatever.

Chairman LUNDINE. Go ahead.

Mr. BEREUTER. Thank you, Mr. Chairman.

Dr. Setubal, several weeks ago we had recommendations that one method for United States and other foreign banks to begin to cope with repayment of debt from Latin American countries was to begin to accept equity positions in certain public and private corporations. I wonder if you have a reaction to that?

Second, I would like to have your reaction to the charge that we hear leveled against the MDB, the World Bank and regional development banks, that they are more likely to look for public solutions in the development problem area and are more likely to be international interventionists in their approach, perhaps because of the fact that it is run by a group of international bureaucrats.

Do you have any reaction to that criticism and the question of the equity position which is a little removed from our hearing today, I admit?

Mr. SETUBAL. As far as the equity position is concerned, I think it is a great solution. The point is that Brazil and the United States do not have a bilateral taxation agreement, so the taxes that are paid in Brazil and the exemption of taxes you are entitled to in Brazil, for example, particularly in the northeast part of the country where you can invest as much as 50 percent of your income tax, is not recognized by the States. So you do that in Brazil and you have to pay it again here.

This is the reason why most of the American firms resist to change from loans to equity.

The second reason is even more impressive, that is the fact that until now or very recently, I think still, the Brazilian Government would prefer even stimulating loans instead of equity because you could pay the prime rate on a loan intercompany and you can only take from Brazil 12.5 percent on the private that you make on the capital investments, because Brazil needs the fresh money that would come in on the loan position instead of the investment that exists there.

So the two points put together to make a very sound decision for a company not to put, not to change its intercompany loans to equity.

Now, as far as the position of the international institutions getting involved with the public position, I couldn't follow quite clearly what your point is. Is it the fact that——

Mr. BEREUTER. They are more likely to look for public, State-owned, entities or solutions to development problems versus the private sector in that country.

Mr. SETUBAL. I see. This is more of a technical attitude of normal banking way of looking at it. If you loan $50 million to one company, the cost is *x*; if you loan $50 million to 50 companies, the cost is at least 10 times more. You know, the trouble you get involved with 50 different companies in a country where information and statistics and the economy is so complicated that the large institutions tend to concentrate in single large companies and the ones that really have money, at least in Brazil, are the State-owned companies. The Brazilian Government today is responsible for almost 70 percent of the economy today.

This is what we are fighting very, very hard. It is not easy to get that enormous elephant from our back, because the State-owned companies are more powerful today than the ministers themselves.

Most of them are unprofitable, so actually we are being taxed indirectly, the Brazilian taxpayer, through the paying of the unprofitable activities of the State-owned companies.

Mr. CARLUCCI. Mr. Bereuter——

Mr. BEREUTER. That leads us to an end that is not very desirable. I don't doubt what you are saying might be the case.

Yes, sir, Mr. Carlucci.

Mr. CARLUCCI. I would like to read into the record a quote from Tom Clausen of the World Bank that substantiates the point you made, but also indicates that he is advocating a change in the approach.

In a speech in London on February 26, he said in this dialog with government AID organizations, both multilateral and bilateral, have been less concerned with promoting private sector growth

than with assisting the development of an effective public sector. That emphasis in my view is misplaced. AID agencies ought to be taking, and must take, a more balanced approach.

So I think the World Bank is beginning to evolve in the right direction.

Mr. BEREUTER. We look for the easy way and it is suggested by Dr. Setubal, perhaps we look for the large entity and that would lead us to an emphasis on largeness and State enterprises.

Mr. CARLUCCI. Parastatal, yes, agencies.

Mr. BEREUTER. My last question, Mr. Chairman. Our Office of Technology Assessment in looking at the hunger problems of Africa has looked at the situation in a number of West African nations, and suggested the creation of small, one-person to five-person enterprises related to moving from subsistence to commercial farming or processing of agricultural products. To make the breakthrough, you have to work with the women in that society, of course. For cultural reasons.

That is the only way to have substantial success.

I don't think it is recent, but we have reemphasized assistance to working with women in those countries on a primary basis direct to the women and those families.

What do you think about, first of all the assessment provided by OTA, and if you have any knowledge on the creation of small enterprises in Africa, is this a legitimate conclusion and are the AID Programs aimed in the right direction in concentrating on the females in that society?

Mr. LIEDHOLM. It is a good point, Congressman Bereuter. You look at a lot of the developing countries of West Africa in particular, you do see that many of the entrepreneurs as I mentioned in the exhibits that are in my presentation, indicated that women play a key role in not only the manufacturing establishments of these countries, but in the marketing and other areas, particularly when you get into the rural areas. The rural household is a complicated multifasceted organism and male and female members are engaged in many different activities over the course of the year. There is specialization by task and some of the tasks are the primary function of women.

So often we have not perhaps taken proper cognizance of that so I think that an approach that does examine that and take account of that seems a reasonable and proper approach indeed.

Mr. BEREUTER. Thank you, Mr. Chairman.

Chairman LUNDINE. Mr. Levin, do you have further questions?

Mr. LEVIN. No, Mr. Chairman, I think this has been a most helpful hearing, however, and I think the quote from Clausen that Mr. Carlucci read is right on. I think a lot of us have had an impression that in terms of balance, the World Bank has been a much more activist for a number of years and the regional banks much less so. They seem to look upon themselves more as banks than as development entities.

I may be inaccurate in that, but that is the impression I think of a lot of people, including myself, and I think one of the challenges to the subcommittee is the one that has been undertaken under the chairman's leadership with active involvement of Doug Bereuter and others, and that is how to increase the dialog with the regional

banks on this and other policy issues, including for example, human resources.

They have very much refrained from any major lending in the human resource area—health, population, they stay miles away. Even a lot of training efforts do.

I think that while this subcommittee will be far from presumptuous, we understand our role and the subtleties. There needs to be a way to open up the dialog with the Bank, maybe that has not been balanced. The World Bank has been very heavily useful, but the regional banks, it is just harder to get a handle on that.

Maybe as we leave you can provide us some further guidance as to how we do that.

Chairman LUNDINE. Thank you, Mr. Levin.

I am just going to ask one other question.

Is there any significant obstacle standing in the way of the development of a more vibrant private sector in the lesser developed and developing countries that you have not had a chance to address, either in your testimony or in the questions and answers?

Mr. CARLUCCI. Mr. Chairman, there are all kinds of obstacles, price distortions, biases against certain types of foreign investment, there are biases in favor of domestic investment versus foreign investment. Countries are coming increasingly to realize that they pay a very high price for this kind of thing, and are adopting investment codes designed to even out some of these distortions. But frankly, many of them have a long way to go.

Chairman LUNDINE. Yes.

Dr. HAYES. I think also the whole question of relative access to capital and credit is a critical issue which affects the small entrepreneur as well as the larger entrepreneur, and where you have the public sector dominating the manufacturing and investment, they are taking away from private entrepreneurs the little bit of credit that is left in the system.

Mr. SETUBAL. On the point of view of a developing country, I would say that what we see is it is the fact that most of the financing of the large banking institutions has some restrictions. For instance, 30 percent of the equipment must be bought in a certain country.

This sometimes keeps the local industry in a difficult situation because we cannot use what we sell because what you are selling is not the equipment, you are selling the financing only.

I think this should have——

Chairman LUNDINE. In other words a U.S. bank, to take an example, goes to Brazil and they provide financing for some venture, but they provide that 30 percent of the purchases for that venture has to come from U.S. firms?

Mr. SETUBAL. That is it.

Chairman LUNDINE. A private bank from this country?

Mr. SETUBAL. No, not private.

Chairman LUNDINE. You mean the development banks.

Mr. SETUBAL. Sure. Not private banks, no.

Chairman LUNDINE. Thank you very much.

I really appreciate the richness of the experience and insight that you have afforded us. I think probably one of the most incisive ways that one could judge the value of these hearings, is if we are

left with all sorts of questions that we would still like to ask when the time is effectively up. If judged on that basis, this has been a very high quality panel because I think that there are many, many more questions that all three of us would like to have answered.

Thank you very much for your contribution to our understanding of these issues.

Mr. CARLUCCI. Thank you.

Dr. HAYES. Thank you.

Mr. SETUBAL. Thank you.

Mr. LIEDHOLM. Thank you, Mr. Chairman.

[Whereupon, at 11:25 a.m., the subcommittee was adjourned.]

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